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EVALUATION OF ECONOMIC INTEGRATION  
IN CENTRAL AMERICA



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## PRESENTATION

The present report was prepared by the secretariat of ECLA - in conformity with the request made by the Central American Economic Council at its eighth special session - for presentation at the ninth session of the Central American Economic Co-operation Committee. It reviews integration activities in Central America from 1961 to 1965, within a broader context and on the basis of the results of a great many contacts and interviews with the national authorities, regional officials and members of the private sector. A provisional version was distributed to the Central American Governments and integration bodies at the end of 1965 and was examined in conjunction with groups of public officials of the five countries concerned and with the directors of the said integration bodies in October and November 1965 and January 1966, as part of an evaluation process which is to culminate in the ninth session of the Committee.

The aim here has not been to describe the results achieved, but rather to analyse the critical problems and factors which have arisen as the integration programme advances. However, this should not be allowed to obscure the basic fact that the Central American common market is already a going concern whose internal trade and investment operations amount to significant and steadily increasing sums. There is no doubt - as is internationally recognized - that it is the most advanced multilateral economic integration movement among the developing countries.

This study aims at presenting an over-all picture of the present state of integration, its prospects and possible trends, bringing out in each case those problems which appear most urgent and important. The detailed analysis which many of these questions require should, therefore, be contained in special studies, some of which - in addition to those completed earlier - will be available at the same time as this report and will serve to illustrate certain points therein. Moreover, although an effort has been made to adopt a long-term approach, some of the proposals and suggestions formulated could be applied over the short term.

/Some branches

Some branches of activity, such as economic and social planning,<sup>\*</sup> and various fairly important transport activities are not dwelt on in this report. However, the most outstanding omission is undoubtedly the lack of a thorough examination of Central America's social policy problems and their bearing on economic integration.

Although, needless to say, these problems act as a powerful curb on the growth of the Central American countries, from the specific standpoint of integration they have not been decisive limiting factors during the formation of the common market. But now that it is actually established, with production increasing within its framework, it is not only desirable but necessary for economic integration efforts to be concerned with the study and solution of those problems. This is essential if the common market is to operate smoothly and also because of the imperative need to distribute its benefits equitably among the various population groups.

Economic integration is not a substitute for the income distribution measures which are so urgently needed at the national level. If properly directed, it is rather a positive and powerful means of implementing them more efficiently and of reducing social costs.

However, some headway has been made in research on the subject, with the studies on cost and productivity levels of industrial manpower, prepared by the International Labour Organisation (ILO) and the ECLA secretariat at the request of the Central American Economic Co-operation Committee, of which the preliminary versions will soon be submitted for the Governments' consideration. The recent establishment of the Central American Labour and Social Security Council is another important step in the right direction. But what is still lacking is the formal recognition and definition of social policy as one of the principal

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<sup>\*</sup> The ECLA secretariat's viewpoints on this subject are set forth in the report La institucionalización regional de la planificación en Centroamérica, presented to the Central American Economic Council by the OAS/IDB/ECLA/SIECA/BCIE Advisory Committee on Planning.

fields of integration at its present stage, and the organization of a broader and more ambitious programme of activities, involving not only studies, but also specific action.

On no account could this or any other evaluation be considered as definitive. Economic integration will always be an incomplete project whose needs will continue to change and increase as the process forges ahead. Accordingly, under a changing and flexible long-term strategy - adapted to the needs and possibilities of each stage - the multinational economic spheres of action will gradually increase. Once an integrated development model is successfully established, the elimination of border customs and the institution of a customs union will be no more than a formal requisite and the natural outcome of a process which has attained the target of a genuine economic union among the five countries.

## I. INTEGRATION AS A DEVELOPMENT MODEL

### 1. The Central American economy in the post-war period

#### (a) Depression in the traditional economic system

At the beginning of the Second World War the economies of the Central American countries had been at a complete standstill for nearly a decade. The prices of the main exports had dropped substantially, with the resulting adverse effects on income. This was reflected in the increasing difficulties affecting production for the export market and, in combination with other limiting factors, it curbed the growth of supplies for export, thereby limiting import capacity and demand. The Central American countries also faced a serious unemployment problem and a lack of investment; they were unable to absorb the population increase economically and productively or to improve per capita consumption and the living levels of the population.

This state of affairs was to some extent influenced by the conditions of chronic instability which, as time went on, had come to affect the economies of the five countries concerned. But other longer-term forces were also responsible for aggravating and prolonging the situation, thereby contributing to a permanent lack of economic viability in the systems concerned rather than to a merely periodic and transitory depression. In fact, in addition to the frequent fluctuations in the world economy and export markets, the long-term growth rate of Central America's coffee production had begun to decline at the beginning of the present century; the banana industry had suffered the effects of pests and soil depletion since 1915, and mining had lost nearly all its impetus since the mid 1920's.

Thus, the traditional outward-directed development model, based almost entirely on export agriculture, had long been inadequate, a fact which became clearly apparent at the time of the world Depression in the early thirties. Since then, stagnation became the characteristic feature of the economic system, the alternative of an inward-directed development process based on industrialization and import substitution being out of the question

/because of



because of the small size of the domestic markets, the existence of a relative price structure which notably favoured exports, and the almost complete inability to master the technology which the more advanced countries had been acquiring for over a century.

(b) Early attempts to reconstruct the national economy

These conditions prevailed throughout the Second World War and were aggravated by the foreign trade limitations imposed by the war. Subsequently, there began to appear signs that production in the various Central American countries was again being encouraged. In the first place, the relative shortage of imports and the freedom from foreign competition enjoyed by domestic production led to the establishment of several light industries, e.g., textiles and processed foodstuffs. Secondly, various bilateral programmes between the United States and some of the Central American countries were implemented with the aim of promoting the production of raw materials - e.g., rubber and hemp - the main sources of supply of which in south-east Asia had been cut off. Lastly, the temporary increase in Panama Canal operations promoted exports of certain food products and absorbed appreciable contingents of workers from the area.

The end of hostilities marked a period of considerable prosperity in Central America - the first for twenty years - which extended throughout the ensuing decade. With the removal of external controls on supplies, the pent-up demand for exports - which had increased considerably between 1940 and 1945 - resulted in a rapid rise in coffee prices, while the banana output, which had contracted owing to the shortage of transport, expanded substantially. What is more, the foreign exchange reserves accumulated during the war made it possible to meet Central America's deferred demand by means of rapid increase in imports.

The first post-war decade cannot be considered merely as a period of recovery. Important legal and institutional advances in the sphere of economic policy enabled advantage to be taken of that span to give fresh impetus to the Central American countries' growth. The measures concerned were adopted in response to the need to provide the State

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with an efficient set of instruments with which to fulfil its responsibilities in connexion with promoting the economy in the face of the problems deriving from the breakdown in multilateralism in the world economy; to the hopes and desires for improved living conditions which had been taking shape for some years; and to those which had stemmed from the war itself and from the events that immediately followed the cessation of hostilities and were part of the task of establishing a new state of affairs in the political and economic sphere.

Thus, a central bank for the five countries was set up in the fifties; public works institutions and programmes were established and strengthened; steps were taken to promote agricultural and industrial development; and an all-out effort was made in the field of social policy through labour legislation, housing programmes and health and social security services. This led to a number of achievements comprising a rapid and sustained increase in investment and manufacturing output; modernization of the traditional export agriculture; the opening-up of new and highly productive agricultural areas; the development of cotton production as one of the main sources of foreign exchange and, to a lesser degree, of fisheries and livestock breeding for export. Urbanization was intensified and, as the situation in Europe reverted to normal, the pre-war foreign trade pattern was largely restored.

(c) Continued inadequacy of the traditional development model

The achievements of the Central American countries in the first ten years after the war made it possible to restore the balance, and therefore the dynamic force, of the external sector; to make better use of available resources; and to expand the domestic base of each country's production capacity, thereby raising income and improving the living conditions of specific population groups, particularly in the urban sectors. All this, however, was not enough to inject into these economies the dynamism they needed. The Central American experience during this period should be interpreted as a functional improvement of the economy rather than as a basic change in the structure of the system.

/In practice

In practice, the product increased faster than the population, but this difference in rate did not substantially alter the former state of affairs. Moreover, the increase was unequal, being concentrated in Nicaragua, Costa Rica and, to a lesser extent, El Salvador, while it barely equalled the population growth in the remaining two countries. Furthermore, the rapid development which took place in Nicaragua during that and the ensuing decade was primarily the result of the establishment of an agricultural export economy which had already existed in the rest of Central America for the previous fifty years.

The difficulties in the way of providing productive employment for the economically active population and of increasing wages still persisted, while steps had yet to be taken to modernize agriculture for the home market. In fact, the output of this sector of the economy increased very slowly, and as a result the first signs appeared of an alarming deterioration in the national diet, coupled with a wider disparity between the levels of well-being of the rural and urban sectors. Industrialization, for its part, failed to produce any important changes in the composition of the product in each country; nor did it alter the model based on light industries, despite the advances made in industrial investment and production.

At the same time, the Central American economies continued to develop within the same state of chronic instability. The decline in export prices, which began in 1954 and lasted until 1960, once again gave rise to the familiar type of income and employment crisis, imports being restricted and the growth rate notably reduced. When the new monetary, fiscal and balance-of-payments mechanisms were first put into effect and had to face an economic contraction in the external sector, they were found to be useful in mitigating the factors of external disequilibrium, but not very efficacious on their own in counteracting the factors of depression and in maintaining increasingly high production and employment levels.

## 2. The economic integration movement

The above inadequacies did not pass unperceived in the Central American countries, even during the boom years of relative prosperity which followed the cessation of hostilities. Particularly evident were the limitations imposed on the development of the manufacturing sector in each country by the small size of the market and the impossibility of attaining full employment on the basis of action at a purely national level. All this - influenced, too, by the tendency to establish economic groupings in other parts of the world - led the five Governments in 1951 to consider the possibility of concerted action which, based on the historical ideal of a Central American union, would promote the gradual and progressive integration of their production systems and facilitate restoration of their long-term economic viability.

### (a) Evolution of the programme

As a first stage, the action to tighten and promote the economic links between the Central American countries was undertaken through bilateral free trade treaties. Within that context, their trade began to expand rapidly, on the basis of the minimum communications already established with the construction of the Pan American Highway, and fed by small agricultural and industrial surpluses. At the same time, with the establishment of the Central American Economic Co-operation Committee within ECLA and of its subsidiary organs, the bases began to be laid for a large-scale economic integration programme, fully Central American in scope.

This programme, based on the practical experience gained from bilateral agreements, the active part constantly played by Governments at different levels, and the results of systematic work comprising technical and economic studies, entered into the decisive stage of implementation in 1958 with the signing of the first multilateral treaties, and culminated in 1960 with the establishment of the common market under the General Treaty. In this way, economic integration has come to operate not only through legal and institutional instruments which establish and regulate free trade in all goods from Central America itself, as well as tariff

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equalization for products from the rest of the world, but also through a set of regional agreements and institutions covering transport, financing, industrialization, investment and public administration.

(b) Broad economic repercussions of integration in Central America

All these advances have resulted in a degree of economic interdependence among the five countries which has already made integration - despite the fact that it is still in its incipient stage - an organic factor of development in Central America's production systems. Several stages may be distinguished in this process. Up to 1950 these countries' economic systems were almost completely directed to markets abroad and at home. They had very few ties with one another, not only because of lack of communications or legal obstacles such as tariff barriers, but primarily because the size and nature of the supply was not such as to support a large and vigorous volume of trade, and the necessary incentives to build up such a supply were lacking.

In the second stage - which was initiated at the beginning of the same decade but did not reach its peak until 1955-60 - integration began to be defined as a new activity of the Central American production systems. Two major factors contributed to this: on the one hand, the progress made by the economic policy of the individual countries with respect to balance of payments, tariff protection, public works and incentives to agriculture and industry acted as a spur to the expansion and diversification of their production capacity base; on the other hand, through the increasingly comprehensive network of bilateral free-trade treaties it was possible to channel a proportion of the growing production capacity to the rest of the area.

However, attention should be drawn to the fact that, when integration activities were intensified in 1955-60 and the prospects of creating a common market gradually brightened, inter-Central American trade began to increase at an accelerated pace and changed rapidly in structure, coming to be based mainly on the manufacturing sector instead of on agriculture, as in the past.

None the less, integration was certainly not a determining factor of Central America's development in either of the two quinquennia. In

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the first period, in which a relative boom took place, its recent initiation prevented it from appreciably affecting the evolution of the economy, which was determined almost exclusively by the export sector, while industrialization was influenced by the growing domestic demand. Nor could integration, in view of the fact that the volume of trade was still very small, influence the situation in general in the second five-year period, which was characterized by a marked depression; but the prospect of progress in integration, combined with the raising of national import tariffs and tax exemption must have helped the manufacturing sector - while not protecting it from the effects of the economic recession - to maintain higher investment and production growth rates than the rest of the economy. During the fifties, therefore, integration was a new and increasingly important component of the production system, without actually becoming an organic part thereof either from the standpoint of its size, which was always limited, or its repercussions, which were not as far-reaching as they might have been.

The position has changed substantially in the last five years. As a result of the establishment of the common market - with widespread free trade, tariff equalization and the incorporation of the production of Costa Rica and Nicaragua in the intra-regional trade flows - inter-Central American trade has grown at an even faster pace, i.e., 42 per cent annually from 1961 to 1964, when it reached 106 million dollars, or about 15 per cent of the area's total imports.<sup>1/</sup>

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<sup>1/</sup> Even if only to recapitulate quantitatively what has been said concerning inter-Central American trade, it would be as well to compare these new figures with the familiar figures for the different stages in the process during the previous decade. At the beginning of the fifties, intra-regional trade amounted to only about 8 million dollars annually, or barely 3 or 4 per cent of Central America's total imports. Between 1950 and 1954 the volume of trade increased to 13 per cent annually, and between 1955 and 1960, with the intensification of integration activities and sound prospects that the common market would be established, the annual average increase rose to 20 per cent. From the figures contained in the text it will be noted that this growth rate doubled in the first four years of the present decade.

Thus, economic integration is already playing its part in the development of production - principally in the manufacturing sector and, on a lesser scale, in agriculture - and has become a factor both influencing and influenced by the general evolution of the economy. Central American demand is one of the factors determining the degree of utilization of installed capacity in industry, and directly affecting investment decisions in regard to its expansion and the addition of new branches of industry. Furthermore, by virtue of the present volume of inter-Central American trade, economic integration is also one of the factors which have a general effect on the production system.

It is true that between 1961 and 1964 this influence was exercised within a climate of renewed prosperity in the export sector. Due to the easing of the world market depression - even though only temporary -, the introduction of techniques in regard to exportable production and the adjustment of its economicity to prices lower than those in force ten years before, the balance has been restored - although only precariously - in most of the Central American countries, and their exports and imports (particularly the latter) have once again expanded. But these factors would not have sufficed to attain the substantial increments registered in the national income had they not been accompanied by economic integration. For example, an appreciable difference is observed in growth rates between this period and the previous boom period from 1950 to 1954. Evidently, the supply of a consolidated multinational demand, combined with investment opportunities such as never existed before, has permitted the attainment of higher economic growth rates than would have been possible without the common market.<sup>2/</sup>

To sum up, in the brief span of fifteen years, Central America has emerged from a situation in which it had five independent economic systems, has introduced economic integration within the context of the traditional development model, and later related it to the operations of

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<sup>2/</sup> The annual growth rate of the Central American economy as a whole rose from 4.2 per cent in 1950-54 to 6.2 per cent in 1961-64.

the production system as a whole. The qualitative change from a non-integrated to an integrated economy has enabled the incentives deriving from the export sector to be turned to better account in further strengthening the national growth process, expanding investment possibilities in these countries and increasing their capacity for absorbing foreign capital.

A question might arise as to the effect now of another more serious world market depression. In so far as it would be possible to maintain an adequate supply of imports of capital goods, intermediate products, raw materials and fuels, the common market and the additional demand generated by production would probably serve, in some degree, to offset the economic recession. But by virtue of the very relationship that has already been established between integration and the rest of the production system, a depression of more serious proportions would inevitably weaken inter-Central American trade, both because of the difficulties that would begin to make themselves felt in keeping up imports of production goods and because of the resulting general reduction in demand.

The above hypothesis completes the analysis of the economic scope so far achieved by integration and places it in its true perspective within the economy as a whole. In this respect, it is clear that the common market is not yet a completely autonomous element in Central America's development and has not yet become the factor determining its growth. On the contrary, as the common market increases in real size, the links forged with the rest of the system tend to make it basically dependent upon export trends in every sector of the economy, while its effect on the economy as a whole is clearly negligible.

Thus, integration has not changed Central America's development problems but constitutes a means of tackling them and provides the basis for expanding and structurally transforming a group of production systems which - in view of their small size, even if taken as a whole - will have to continue evolving in line with an outward-directed development model. This completes the circle of an economic policy which, based originally on an agricultural export economy that fell short of the needs  
/and hopes



and hopes of a growing population, was defined first in terms of the union of five national systems - as a means of restoring that sufficiency on the basis of a larger and more diversified production - and later in terms of the dual requisite of maintaining traditional exports at the highest possible levels and of incorporating the new consolidated system in the international economy in order to serve larger export markets. The closing of this circle also completes the context within which the Central American countries should operate. In fact, it serves to show that while economic integration is a necessary element, the future evolution of the world economy is another equally decisive factor in determining the long-term growth trends of the Central American economies.

3. Economic interdependence between countries and  
common market problems

Bringing the common market into full operation, its internal development and its proper adjustment to the set of international economic relationships in Central America call for the necessary action by Governments in the present stage of economic integration. It is precisely in these fields that the problems arising from the introduction of free trade and tariff equalization are encountered.

Thus, the Governments are beginning to be concerned about the lack of flexibility in duly adjusting the standard import tariff to changing development needs, and the obstacles still limiting flexibility in intra-area trade flows. The revenue losses resulting from trade liberalization and the possibility that unilateral action to offset them might come to shatter the unity of the common market and distort its development are other sources of concern.

Moreover, the supreme organ of the General Treaty - the Central American Economic Council - has repeatedly stressed that it is essential: (i) to guide the structure of industry within the context of the common market; (ii) to meet the agricultural sector's regional needs; (iii) to place the Central American entrepreneur on an equal footing with the foreign investor; (iv) to strengthen competition in the free-trade area; and (v) to provide free trade with an economic infrastructure

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in keeping with its volume and needs. Lastly, the effectiveness of integration institutions, the balance of development among the five countries concerned, and Central America's economic relations with the rest of the world have become increasingly urgent problems.

The existence of all these problems does not mean that Central American economic integration is in the balance, and still less that it is sliding backwards. They are problems connected with growth, not with the stagnation of the process, and arise from the progress already made rather than from unexpected setbacks.

Such problems should be regarded as logically deriving from integration, and must certainly be solved gradually through a sustained and systematic improvement in its operations. However, the gravest concern might be that this undertaking is not going ahead in Central America as promptly and decisively as it should. Although basically the common market has operated in a highly satisfactory manner, the fact remains that as the period of transition advances, obstacles as yet not overcome have been encountered and certain difficulties in the way of attaining new and higher levels of integration among the five countries have begun to emerge.

None of these problems are important enough in themselves to jeopardize the progress already achieved. But if their solution is postponed and other problems arising from the very dynamism of the common market are added to them, it is evident that serious difficulties might loom ahead for integration, as regards not only the attainment of its new aims, but also the preservation of the development it has accomplished to date. Therefore, it is not intended here to work out new and different economic conceptions of Central American integration, but rather to adopt a practical approach - consistent with the broad guidelines previously established by the Central American Economic Co-operation Committee - to the question of carrying on a group of activities, most of which have already been initiated, to the decisive stages of specific action and implementation.

It has been thought fit to open this analysis of common market problems with a number of general considerations regarding various facts

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that are common to them all, before going on to review the peculiar characteristics and requisites presented by each. It must be borne in mind that those problems are not independent of each other; nor do they arise separately. Many of them are the result of a new phenomenon: the growing interdependence between five production systems which, until a short time ago, had virtually no economic links between them.

As regards free trade and tariff equalization, this interdependence was expressly laid down in the General Treaty and in the related common market agreements. The procedure to be followed by each member country in both connexions under that new relationship was fully described in those instruments, although experience in the first few years has shown the need for certain adjustments in order to give greater flexibility to the common import tariff and, therefore, to the intra-area trade flows.

However, economic interdependence has a far broader radius of action in practice. Precisely by virtue of the establishment of a single regional market, each country's action in other aspects of the production system has ceased to be completely independent, influencing and being influenced by the action of the rest. Thus, for example, certain tax measures adopted by one Government may have a limiting effect on trade flows with other countries and, likewise a national programme of imports from third countries which are subsidized by them may limit supplies from the rest of the common market. Industrial investment decisions, for their part, no longer affect only the country in which they are adopted, but those adopted by other countries as well and, in general, the structure of manufacturing industry in the area. Moreover, one country's foreign investment policy may be offset or vitiated by a conflicting policy adopted by the rest. Lastly, the concept of an outward-directed national trade policy has lost virtually all its significance, and the impact of monetary policy is felt not only in the country itself but also in the behaviour of the neighbouring economies; the advance of social programmes, inasmuch as it affects the competitive position of specific lines of production, may be held up by the slowness of action of some members of the integration movement. The particular

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development of certain countries might also affect the balanced growth of the whole area, since this has become part of the problem which devolves upon each individual member.

This can be regarded, therefore, as a de facto interdependence which transcends the subjects of the integration treaties in force and is manifest in nearly all the other major fields of economic policy. For want of adequate instruments to guide and co-ordinate the action of the member countries in terms of the needs inherent in the new situation they have created, each country has until now had to follow its own criterion, taking the initiative in the interests of its own production activities and reacting independently to the unilateral action taken by the rest. Basically, it is this disparity in a situation which calls for a proper reciprocal adjustment of the five countries: behaviour, and the want of such adjustment, that give rise to many of the common market problems.

This state of affairs and the need to adopt the necessary measures to remedy it are not always recognized. There is sometimes a tendency to think and act as if a country could develop within the framework of the common market only at the expense of the other members, while the fact is ignored that the latter could adopt the same attitude and those that did not would suddenly or gradually stop co-operating voluntarily in economic integration.

It is essential to recognize that, in order to ensure the smooth operation and ultimate development of the common market, the existing de facto interdependence should be converted into a de jure interdependence in order to prevent frequent contradictions and fulfil the development expectations that have been created. The purpose of the analyses presented in the second part of this report is precisely to determine along what lines this transformation could take place.

4. The temporary co-existence of integration and the traditional economic model

The statement that the national and the regional interest are sometimes basically opposed is completely unfounded. The regional interest does not rest on an abstract entity or on a real situation other than

/that of

that of the countries participating in the integration movement. It is shared equally by all five countries and in each is as much a national interest as any other. Therefore, they are not called upon to sacrifice their own interests for the sake of an integration that is in any way alien to them.

There might on occasion be some contradiction between a country's interest within its traditional development model and the general interest - which it also shares - under the new model it is sought to establish. But such cases cannot be regarded as opposition between countries, or between national and regional institutions, they are the natural contradictions arising between different development models during the formative stages of one such model, just as at the end of the nineteenth century the incipient agricultural export economy clashed with the previously established agrarian and trade system.

The real nature of these conflicts having been clarified, their existence is clearly of vital importance since the continued progress of economic integration depends on whether they can be settled, and therein lie the transcendental problems facing the common market. On the other hand, these problems stem precisely from the need to reconcile the conflicting interests at stake, and to channel and direct the transformation of the existing structure of production. In fact, if those contradictions and controversies did not exist, there would be no reason for economic policy to be concerned with the situations they bring about, nor would integration have such obstacles to face.

Accordingly, Central American integration at present is not only at a stage where immediate possibilities are turned to account, but is basically in a state of transition between two different development models; an incipient transition, moreover, the development of which makes it clear that many of the principal economic policy measures required should cover not merely the functioning of the economy but also the changes in its structure.

(a) Persistence of the traditional economic system

In this respect, it must be recognized that the common market has as yet brought about only minor changes in each country's system as a

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whole and that the structure of the individual economies is still based on the traditional national model. This is true not only of the infrastructure - energy, transport and communications - but also of the financial sector and a great deal of the legal and institutional machinery through which production activities are channelled. All these factors continue to operate in terms of the needs of the existing domestic production system - which is still playing a negligible part in the common market - and, therefore, independently of the lines followed by free trade and the standard import tariff. Consequently their action sometimes conflicts, but in no case do all these factors operate harmoniously in terms of integration interests and aims.

Accordingly, within the above-mentioned economic interdependence among countries, the common market problems are closely related to the coexistence - as yet unorganized and unregulated - of two kinds of factors relating to two different types of economic structure: some new and fairly weak, and others well established and stronger because of their proportions and the additional stimulus they derive from the characteristic inertia of all traditional activities. Thus, in working out the government budget, the tendency is to give more priority to local public works than to regional infrastructural projects; in adopting industrial investment decisions - although it entails a duplication of effort - preference is given to the better known fields and the size of plant chosen is essentially in line with the size of a domestic market, as being a safer proportion, while only a small output is envisaged to supply other countries; and as regards integration needs in the agricultural sector, free trade is usually sacrificed to the maintenance of certain conditions in a specific segment of domestic agriculture. Moreover, whenever it is really essential to take the existence of the common market into account, this consideration gives rise to competition between countries in turning their own possibilities to account, but within the pattern characterizing their systems, as in the case of domestic legislation providing incentives to industrial development.

(b) Implications for economic policy

In actual practice, these are all real problems which cannot be overlooked in a zealous desire for integration, and little can be done to develop the common market unless they are solved. After all, the immediate economic survival of the Central American countries is still essentially dependent upon their own production systems and it would not be reasonable to jeopardize it in favour of an as yet non-existent regional system. Once the physical bases of such a system are established and its development is comparatively more advanced than that of the other systems, the co-existence of different development models will alter in nature and the existing contradictions, which, in the last analysis are merely a transitory problem, will tend to disappear.

But the immediate situation is very different: the present aim is precisely to promote such a transition, on the basis of the existing systems and by taking whatever opportunity offers to transform them through the vehicle - also already established - of the common market.

In the first place, a distinction should be drawn between the spheres of action of specific internal policies, in order to meet common market requirements without detriment to those of other activities such as - within the context of credit policy - the financing of inter-Central American exports. Secondly, it is imperative to recognize that certain integration needs do not replace, but are supplementary to domestic needs - for example, regional public works in relation to local projects -, and to orient government financial policy in line with this criterion. In such cases, external credit could come to play an important role, a fact which is illustrated by the establishment of the Central American Integration Fund.

These are perhaps the simplest aspects of the problem. In other respects the position is more complicated and two cases in particular are worthy of mention. In the first place, economic integration tends to alter the operation of established domestic activities or the content of policies conceived at that level. Examples of this include the traditional manufacturing industries and certain agricultural lines of

/production intended

production intended for the home market. To effect the adjustments required by integration generally calls for specific programmes aimed at specialization, modernization and expansion of installed capacity - as in the textile industry of the five countries in question -, or at the reorganization of the use of resources - as in the production of basic cereals in certain areas of El Salvador and Costa Rica. Such programmes could not be implemented only on the basis of free trade and tariff equalization; they would have to have a promotional aspect, with the addition of such factors as credit, technical assistance and legal and tax measures.

The second instance relates to circumstances where action at the national level must be re-oriented in order to bring it into line with the norms agreed upon at a multilateral level - e.g., the co-ordination of tax systems and the standardization of tariff legislation - or to harmonize and strengthen it at the Central American level, as in trade policy, the Régime for Central American Integration Industries, and the inter-connexion and combined development of the electric energy systems. While some of these activities, by their nature and scope, can continue to develop at the national operational centres themselves, merely requiring co-ordination at the Central American level, others go beyond the radius of action of each country taken separately because of the limitations imposed by the integration treaties in force, the inadequate facilities for carrying them out at the national level, or their important repercussions on the region as a whole.

These situations will give rise to further development of the legal and institutional machinery at a Central American level with the purpose in some cases, of guiding government action, and in others of encouraging the private sector to co-ordinate entrepreneurial resources and to channel domestic saving into regional enterprises and projects. Besides the technical and economic issues that would have to be clarified in each instance, this will require the institution of planning and implementation procedures that will safeguard the regional viewpoint in action taken at the national level, and vice versa, as the case might be.



5. Limitations and possibilities in the transition to  
an integrated development model

The formulation and adaptation of an economic policy with the two-fold objective of meeting the needs of the existing production system and of transforming its structure within the context of an integration model is a complex and difficult task, partly because the first objective essentially restricts the type of measures that would have to be taken to attain the second.

(a) Restrictions hampering changes in the relative price structure

For example, one well-known method of promoting a change in the structure of production is to raise the prices of manufactured goods in relation to the products of other economic sectors. However, the possibility of doing so in Central America is limited by the need to maintain the volume of traditional exports at the maximum levels compatible with external market opportunities, an essential requisite if the economy and integration itself are to develop satisfactorily. In fact, once a certain point has been passed, price changes in that direction would tend to result in a shift of such exports to industry and the magnitude of this shift might jeopardize the efficient operation and expansion of the production activities concerned.

Moreover, if the internal market is to be supplied from internal sources - i.e., through import substitution - regional production must be protected from foreign competition by altering price relations in its favour, in view of the far from adequate techniques practised in Central America and the low standard of skill of its labour force. However, the extent to which this should be done is limited by the need to increase and diversify exports, as consistent with the relatively small size of the common market. Too great a disparity in costs with respect to other countries would necessarily weaken Central America's competitive position in the world economy.

Lastly, in the manufacturing sector proper it is difficult to reduce the unduly strong protection enjoyed by certain industries in the area. But until this is done and while such industries are still in a position to accumulate what are sometimes substantial profits on the basis of

/inefficient plant

inefficient plant size, outmoded techniques and obsolete equipment, the price system cannot be expected to contribute to the modernization and specialization of those activities, or to the establishment of other industries based on a larger investment, more complex techniques and a relatively lower return.

These facts lead to the following conclusions. It is evident that, on the one hand, the real possibilities of promoting integrated development through the relative price system are, in some degree, limited; and, on the other hand, whatever those possibilities might be, specific provisions would be needed in addition to general measures if advantage is to be taken of them. These provisions would cover, inter alia, particular aspects of monetary, credit and balance of payments policy, e.g. selective controls in respect of the volume of loans, different cash deposit requirements and other measures designed to arrest the growth of certain imports. However, the implementation of such provisions at this stage would entail serious difficulties, in view of the reluctance of the central banking system to use those types of controls and its marked and understandable propensity to base its action almost exclusively on the broad instruments at its disposal. None the less, the inadequacy of those instruments and the need to supplement them with selective quantitative provisions will gradually become more apparent as the internal production system expands, its activities become more and more diversified, imports of capital goods and raw materials increase and industrial and agricultural employment rises.

A third and last conclusion is that as a result of these limitations the Central American countries, in formulating and adopting their economic policy in line with the two-fold objective alluded to above, will have to base their action not only on the relative price structure, but also on other types of instruments, flexibly adapting the whole set in accordance with the changing needs and opportunities arising at each stage.

(b) Achievements in the price system

This last approach corresponds in some degree to what is already happening in Central America. Within the context of a fairly stable

/monetary and

monetary and fiscal policy, price relations have registered changes in favour of industrialization during the past ten years. The drop in traditional export prices, combined with tax exemption and tariff protection measures, has provided an incentive to domestic production.

As a whole, these changes must have been on a rather small scale, both because of the limitations imposed by the general stabilization policy and because - in view of the short time that has elapsed and the export sector's needs - it would in any case have been impossible to offset the cumulative counter-effects of the frequent earlier depressions, repeated monetary devaluation and fiscal disequilibria. However, there is much that can and should be done under the present circumstances, by means of only minor changes before it should become necessary to continue the process by effecting new changes in the whole price system.

(c) Opportunities and need for action in other spheres

On the one hand, the achievements in this field have been substantially reinforced by the substantial increase in available demand deriving from consolidation of the domestic markets in the common market and establishing a uniform tariff policy at the regional level. On the other hand, if the opportunities thus established are to be turned to account, it is essential to set up appropriate mechanisms for tapping domestic saving, to train large numbers of technical and entrepreneurial personnel and to undertake other economic development activities. As distinct from the industrialized countries - which have up-to-date techniques and no lack of trained personnel and whose structure of production and institutional framework are already firmly established -, in the developing countries the effects of changes in the price system are undermined by the lack of those factors and additional measures must be taken to create them.

In this respect, there are two main requirements facing the Central American countries today as regards the formulation of their economic policy within the context of the common market: (i) to improve the legal, institutional and administrative basis for integration, and (ii) to provide the common market with an economic infrastructure commensurate with its size.

/The former

The former requirements does not only relate to improving the legal framework of the common market, free trade and tariff equalization. It consists primarily in supplementing and reinforcing that framework through the strengthening and co-ordination of promotional, financial and technical instruments.

The action this entails would have to be crystallized in a Central American common market development policy embracing, as a first stage, industrial, agricultural and foreign trade activities, together with social services, and as a second stage, fiscal, monetary, banking and organizational questions, and trade practices. Because of its scope and complexity, this process would have to be accomplished gradually through the resolute application of tariff, financial and tax instruments and the action of the development institutions which already exist at the regional level - the common import tariff, the Central American Bank for Economic Integration (BCIE), the uniform tax incentives to industrial development, the Régime for Central American Integration Industries, the Central American preferential tariff and the Central American Research Institute for Industry (ICAITI) -, and through the co-ordination and modernization of specific legislation.

The second task - i.e., that of providing the common market with an economic infrastructure - does not consist simply in continuing to develop the existing national systems, but in expanding them and standardizing them at the regional level, while at the same time transforming them as to size, economic scale and technical characteristics. Its execution requires that new integration agreements be concluded and government administrative action be adapted along such lines as to give a vigorous impetus to regional programmes in the various sectors of the economic infrastructure. Only thus will it be possible to create the external economies needed for the development of the common market in consonance with its size and on the basis of adequate services and decreasing real costs.

#### 6. The balanced growth of the five countries

A relatively high and still increasing degree of economic interdependence and the temporary co-existence of two different development models have imposed on integration its present peculiar characteristics. But the complex

/nature of

nature of the tasks to which this gives rise are fully realized only if consideration is given to the Government's additional intention of promoting the development of the structure of production in accordance with well-defined guidelines in regard to the degree and type of member-country participation it is intended to secure in the process.

(a) Available legal and institutional instruments

The establishment of the common market in Central America does not mean that integrated growth should come about spontaneously, merely as a result of the stimulating effect of free trade and the standard import tariff on the five previously established economic systems. The necessity of simultaneously encouraging the balanced growth of the five countries has been recognized from the outset, and this is one of the cardinal objectives of economic integration. Tariff equalization and the uniform tax incentives to industrial development were formulated partly with the two-fold purpose of preventing the disequilibria that might arise from disparities between countries as regards this type of factor, and of ensuring a basic balance among them all in the two fields in question. The Agreement on the Régime for Central American Integration Industries was also instituted partly with the aim of guaranteeing the relatively less developed members, an equitable share in regional industrialization, and the action of BCIE was also defined from the very outset in terms of promoting a balanced development of the countries. Thus, the common market has been furnished with various instruments designed, on the one hand, to guarantee equal conditions for countries on an equal footing and, on the other, to establish a scale of terms intended to mitigate the disadvantages that the relatively less developed countries might have to face.

However, the practical headway made in promoting a balanced growth within the context of economic integration is still inadequate. Intra-area trade is still concentrated in three countries, and the gap between the more backward and the more advanced countries, instead of shrinking, seems to be exactly the same. There is another aggravating factor: now that the common market is established, the scant progress made in the above objective is serving to increase the difficulties arising in connexion with

/the flexibility

the flexibility of free trade, and is tending to obstruct the advance of integration in other spheres, as will be seen when the present state of the regional programmes is reviewed by sector.

The problem of development balanced is not due to the lack of suitable instruments to deal with it, but to the fact that in some cases they have not been implemented or have been misapplied, and in general to the want of a clear conception of what Central America's situation is in this connexion and of a determined effort to settle it. For instance, of the instruments designed to promote equilibrium, the standard import tariff is the only one that has begun to have some effect. The uniform tax incentives are not yet in force and the growth of Central America's integration industries has been somewhat slow, while the development measures adopted by BCIE have yet to produce the desired effects.

(b) The concept of balanced development

The first fact to be recognized is that the initial disequilibrium - which is a characteristic feature of the present situation - is in no way the direct result of the action adopted by the five countries to promote economic integration. On the contrary, this disequilibrium existed before, and its causes must be sought in the past trends followed by their production systems which, while maintaining the common denominator of relative under-development, illustrate the notable disparities in the levels of growth attained by some of the countries. This fact, in turn, explains why - in consolidating the domestic markets in a common market - the most advanced countries are best able to take advantage of the opportunities thus offered.

It would be illogical to expect that the disequilibrium existing today - which is the result of situations that have taken a long time to crystallize - can be remedied in a few short years. Moreover, the fact that such a change must be achieved in terms of a process of integrated economic growth at a multinational level, makes it quite clear that balance development among the Central American countries is an objective which can be attained only over the long term. Nevertheless, a number of measures should be adopted immediately in order to expedite its achievement.

A concept of balanced development which, for example, postulates equal levels of growth for the five countries - in terms of equal per capita income coefficients would in general, if feasible, cast the economic development process in too rigid a mould, would entail curbing progress in the more advanced countries, and might even be fallacious if account is taken of the existing disparities in the countries' resources. On the other hand, an alternative concept based on equal growth rates instead of levels would be insufficient, since it would tend to perpetuate the initial disparities.

Likewise, the maintenance of an equal trade balance between pairs of countries or with Central America as a whole might present the same defect as an indicator of balanced development and, in any case, would cover only part of the evolution of the economic system. It would ignore the positive effects integration might be having on the scale and composition of investment in a country whose trade balance with the rest of the area happened to be negative at a given moment, as well as the increase in exports to the rest of the world which that same country might achieve with common market support. On the other hand, it would be difficult to find grounds for serious objections to a negative trade balance, from the standpoint of equilibrium, if the deficit were due to a shift in the origin of imports from third countries to the rest of Central America.

The above comments serve to illustrate the practical and conceptual deficiencies of certain notions of balanced development and to clarify other aspects thereof. Balanced development should therefore be regarded from a very broad viewpoint which would take primarily into account the evolution of the economy as a whole in each individual country. In relation to the existing disequilibrium in which integration is being launched, this viewpoint includes the initial element of a more realistic conception of the goal pursued if it is admitted that, dynamically speaking, balanced development is virtually synonymous with a process of growth benefiting all member countries, independently of their comparative position as regards levels and over-all rates, or their respective and reciprocal trade balances. This serves to justify participation in an integration movement and to establish the likelihood of balanced development if a

/country's economic

country's economic growth is faster within the common market than outside it. Broadly speaking, this is the characteristic feature of the situation in Central America in the present early stages of economic integration and, therefore, the idea that a country should keep out of this movement because of its relatively more backward stage of development, and join it later under more favourable internal conditions, besides being inaccurate, clearly conflicts with the very interests of the more backward members of the common market.

(c) Balanced development within an economic integration structure

Yet the attainment of higher growth levels and rates with integration than without it is only a piecemeal and temporary solution. Equilibrium being a relative condition, as integration forges ahead it is imperative also to ensure a reasonable and equitable distribution of its benefits among the member countries and through that means to enlist the continuing voluntary participation of all countries in the multinational effort.

If these goals are to be achieved, it is essential from the outset to discard the idea of simply developing identical structures of production in all five countries. Nothing could be more detrimental because of the limiting effects it would have on the expansion of trade and on the evolution of an economy purely Central American in scope, although the existence of competitive lines of production is in some degree a healthy factor in improving the efficiency of the present national system as consistent with integration requirements.

This does not mean that specialization should necessarily evolve along the lines of the traditional model already well known in international trade, i.e., that the less advanced countries should devote themselves to the production of agricultural items and unprocessed raw materials, while the more advanced countries should concentrate their efforts on industrial production. Nor does it mean that the above evolution should also be conducive to the formation of five centres of manufacturing industry, one in each country. Latin American experience shows that even in countries much larger in area than the whole of Central America - Argentina, Brazil and Mexico - there are never more than one or two such centres. On the other hand, a highly decentralized expansion of manufacturing

/industry would



industry would encounter serious difficulties, particularly in its early phases, because of the lack of external economies, which would have to be established by concentrating at specific points the services that are now in short supply: energy, transport, communications and skilled manpower.

The ultimate requirements of balanced development is obviously that the expansion of production capacity and output resulting from integration should extend in reasonable proportions to all the member countries instead of only to a few. This would have to be approached in terms of the establishment of a broad basis of complementary relationships that would facilitate the utilization of the different natural resources owned by each country and enable various production activities to be co-ordinated at the regional level. Thus, the resulting economic structure would be based, not on ties of unilateral dependence, but on increasingly firm relations representing a genuine organic interdependence among countries, which by its very nature would be the foundation for additional and increasing growth in the whole area.

A regional specialization model of this kind should, in turn, develop within a process of industrialization which covers all the Central American countries and enables each of them to transform its primary production in some measure and to promote its technical progress to the full. This makes it necessary to adopt a broad approach to industrialization as defined in terms of a complete qualitative transformation of the technical and production bases of the community, embracing, in addition to the manufacturing sector proper, the agricultural and services sectors, mining, forestry and fisheries, development of the area's human resources, and the relationships between all these activities. It is evident from this approach that industrialization comprises, for example, not only the development of Central America's chemical and metal-transforming industries but also the improvement of techniques in the agricultural sector and the processing of its output, and that the resulting economic processes are closely interrelated.

Thus, it is easy to see that - as the development process advances - the question of an inter-country balance of development is coming more and more to mean balance between economic sectors. Inasmuch as industrial

/development is

development is regarded as a geographically and operationally integrated movement, this balance would gradually come to be centred, on the terms of trade between different production activities, with all the advantages this would bring in overcoming the inflexible nature of the conflicts occurring between countries in their dual capacity as politically and economically different units.

(d) Balanced growth and the economic expediency of investment

The attainment of balanced growth within the framework of Central American integration - as consistent with the broad outline indicated above -, is wholly compatible with the requisite of avoiding the uneconomic location of production activities. What is more, equilibrium can be established and maintained only on the basis of the application of criteria that will ensure the economic expediency of investment in each and all of the countries and will permit the lines of production thus obtained to be consolidated in terms of reasonable competition with other Central American sources of supply or with imports. However, such economic expediency and conditions do not come about automatically. They are the result of measures and efforts which are deliberately calculated to create them, and which are necessary in order to avoid the emergence of new and more serious disparities or the perpetuation of existing ones.

This does not necessarily mean that the competition established between countries on the basis of seizing the opportunities offered by the common market should be weakened or disappear. In practice, these are healthy competitive conditions and should be maintained, since they reflect a dynamic force, the lack of which would constitute a matter of concern. What is required is the addition of multilateral joint action which, from the standpoint of development, would make it possible to take advantage of opportunities that are beyond the possibilities of action at a purely national level because of their magnitude and complexity and, from the standpoint of equilibrium, would help the less developed countries to surmount the obstacles determining their relatively backward stage of growth.

(e) The need for an active balanced development policy

Clearly, the inter-country balance of development can hardly come about as the result of a spontaneous process. On the contrary, the economic forces already established in the common market will probably tend, as a natural consequence, to enable the more advanced production centres to consolidate and strengthen the relatively advantageous position they enjoy at present.

It should be stressed that an indispensable requisite for the attainment of a better balance is an intensive effort on the part of those countries in the least advantageous position today. But at the same time it should be recognized that, partly because their economies are now open to competition from the rest, these countries might be unable to overcome the difficulties in question as successfully or as promptly as integration demands, if they have to rely exclusively on their own limited means.

This illustrates the vital need to put into practice at the Central American level a resolute and vigorous policy which would lead, on the one hand, to the establishment of basic economic infrastructural works in countries and areas at a relatively less advanced stage of growth and, on the other, to the development in those areas of immediately productive activities - agriculture, industry and services - with a view to promoting the utilization of their best natural resources and of the market opportunities - immediate and otherwise - open to them within the framework of a regional economic unit, both in supplying its demand and in using it as a basis for new and different export activities in respect of the rest of the world. In so doing, consideration should be given to the fact that - although this policy will take time to yield satisfactory results - it would have to consist in part of short-term measures for the development of various lines of production based on simple techniques and a low level of investment, in order to make sure that these countries will continue to participate voluntarily in economic integration.

Although they may in themselves be inadequate, the existing common market instruments - in particular BCIE and the Régime for Central American Integration Industries - might serve effectively in carrying

/out this

out this task. In order to take full advantage of what they have to offer, all that is needed is that their use should be co-ordinated and approached from a promotional standpoint. They should also be supplemented by measures for obtaining the technical facilities needed for the preparation and implementation of public investment projects, and for providing the additional capital, skilled personnel and entrepreneurial resources required in the case of agricultural and industrial projects.

Lastly, it should be pointed out that - although vitally important - Central America's policy governing an inter-country balance of development represents only part of the concerted development effort through economic integration. The situation in general is covered by specific economic policies - industrial, agricultural, trade and social - and by the regional programmes by sectors which will be reviewed later. In this respect, it is not a policy that would absorb most of the technical and financial resources available for the common market in terms of the relatively less developed areas. On the contrary, an effort is being made to see that a reasonable proportion of those resources - the total of which would tend otherwise to be used under different conditions - should be earmarked for dealing with the special problems of those areas with the object of reducing the disparities and extending, within a reasonable term, the geographical scope of the development generated by economic integration. It should further be understood that the place now occupied by the relatively less developed countries would necessarily be taken by others in the course of time, as a result of the changing needs and dynamic force of the development process itself.

#### 7. Other considerations

The above analyses bring into focus the increasingly important and complex nature of the task facing the Central American Governments in their effort to further the gradual and progressive integration of their economies. The most significant development in this connexion during the last five years is, perhaps, the exceptional spread of integration as regards the number and size of its spheres of activity.

Up to 1960 the Governments' efforts were mainly focused on establishing a trade policy that would regulate trade relations among the Central American countries, and between them and the rest of the world.

Once that aim was accomplished, the activities demanding the concerted action of the five Governments increased sharply and a whole range of new problems promptly arose in relation not only to the actual operation of the common market but also to agricultural and industrial development, the establishment of infrastructural works and services at the regional level, fiscal questions and economic relation with third countries.

The headway made in improving treaties and in establishing and reinforcing integration organs has facilitated the solution of many of these new problems. Nevertheless, it has proved insufficient to cope with the expansion of activities resulting from the growing opportunities and needs created by integration, since the former cannot be turned to account or the latter satisfied with the facilities currently available.

To remedy that inadequacy is largely the aim of economic integration policy and it is therefore essential to guide Central America's joint action in accordance with a carefully devised strategy.

In the first place, it is imperative to apply a highly selective criterion in determining which activities are to be encouraged in the immediate future. All fields are not equally important, and many of the proposals put forward daily outside the decision-making centres of the common market are only remotely related to the major problems arising.

Secondly, the number of institutions and national and regional officials responsible for carrying out integration activities should be increased in proportion to the growth of the radius of action of the integration movement.

It would also be highly desirable for the Central American countries to continue to improve integration through the methods and procedures which enabled them to forge ahead in the early stages of the programme. Such methods and procedures **include** four essential factors:

- (a) A pragmatic rather than a doctrinaire or theoretical approach to integration questions, permanently and closely related to the problems and needs presented by the integration process in Central America;
- (b) The accumulation of prior experience in specific fields or activities before the application of new measures on a general or - where possible - a multilateral basis, as occurred in the case of some of the treaties in force;
- (c) The close and constant participation and orientation of Governments in all integration activities; and
- (d) External technical co-operation in carrying out basic studies and research on specific problems.

## II. ECONOMIC INTEGRATION POLICY IN SPECIFIC ACTIVITIES

### 1. Consolidation of the common market and bringing it into full operation

The success of Central American economic integration should be judged in the light of a constant comparison with the daily evolution of the common market - as it is understood strictly within the limits of free trade and tariff equalization -, since the policy decisions which have brought it into being can be consolidated only through continuing compliance with its guidelines and frequent verification of the positive effects pursued. And even the targets reached from time to time - for example, the abolition of border customs between the five countries and the extension of free trade to include all goods, both Central American and imported, combined with the complete mobility of the factors of production - will depend upon the results in the next few years of the measures that are only now beginning to be applied.

Accordingly, to keep up the efficient functioning of the common market - of its basic instruments and related agreements - is still the primary requirement at the present stage of integration, since it constitutes the general framework within which the whole process of integrated growth must continue to forge ahead.

This partly explains the increasingly complex nature of the economic integration process described above: not only is it necessary now for the new advances to be effective in attaining additional objectives, but they must also be compatible with free trade and tariff equalization so that these instruments will continue to be strengthened and not weakened. This is particularly important at a time when the Central American economic treaties are being subjected to their first tests, and when the pressures of new and old interests are beginning to clash.

Furthermore, the improvement of the common market should be regarded as possibly the most important economic policy aim to be accomplished in the immediate future. This relates not only to the establishment of free trade for products subject to restrictions of indefinite duration or to tariff equalization for items that are awaiting negotiation but also to

/the institution

the institution of appropriate connexions with other instruments and the adoption of new agreements and administrative measures.

This is probably a more formidable and complex task than the one faced in the nineteenth century - that of obtaining access to world export centres - since it consists not only in reaching an established market, but primarily in creating a new unit - the regional market - and integrating it with existing domestic and world markets. To that end, the behaviour of the various parties to economic transactions must be brought into line with the treaties, in such a way as to favour rather than obstruct economic integration. The confidence and trust of the member Governments and private sectors will depend upon whether that behaviour is permanent, whether effective and well-known procedures are used to modify it in the future, and - particularly in these initial stages - whether the actions of civil servants - both national and regional - in specific circumstances related particularly to the common market are expressly determined beforehand. Thus, the principal treaties will have to be supplemented by more detailed and specific provisions in respect to operation and work.

## 2. Free trade policy

Generally speaking, free trade and tariff equalization have operated satisfactorily so far. However, the favourable initial results, although undoubtedly important, fall short of what is required since the operation of these two factors must be extended to cover a large and constantly increasing flow of future transactions. This flow would have to be directed by rules that would facilitate the transactions concerned and provide for the necessary measures in the event of disputes or difficulty, thereby avoiding the necessity of improvising which is always a dangerous step in this field. The rules in question should be formulated on the basis of real common market operations in line with the methods which have hitherto contributed to the successful results of the economic integration programme.

/The basic



The basic requirement with respect to free trade is to ensure its continuity, a factor which is vital to the States members of the common market and to the individual producers. In fact, the General Treaty (article XI), establishes that trade shall be carried on freely - subject only to the award of a guaranty - even in cases where problems might arise regarding the origin of the goods or the existence of unfair business practices. Experience has shown that it would be advisable to establish regulations governing this clause and, if necessary, the whole of chapter III of the Treaty on the subject of export subsidies and unfair trade practices, in so far as procedures are concerned, in order to ensure its efficient application.

As regards the bulk of the intra-area trade transactions, the existence of stable free trade conditions is dependent upon the procedure adopted for effecting the tariff classification and for determining the origin of goods, and also upon the application of quarantine and other regulations. At the present time, these operations are handled by the national authorities and, for want of standard procedures and common mechanisms for enforcing their application, they are sometimes a source of controversy between those authorities and private interests or other member Governments. Whenever such controversy arises, it is referred to the Permanent Secretariat, the Executive Council or the Economic Council of the General Treaty.

Broadly speaking, all such cases have been satisfactorily settled so far, through arrangements that are acceptable to the interested parties. However, this is not enough to ensure an expeditious liberalization process on a continuing basis. Whatever their origin and nature, these controversies are always costly affairs entailing a waste of time and resources, besides creating uncertainty which restricts incentives to investment and to the establishment of economic commitments in an enterprise of this kind. Thus, the continuity of free trade should be based on the prevention of disputes rather than on their solution once they arise, a point which merits Governments' attention.

/The above

The above target should be accomplished through the application of three types of measures: (a) certificate of origin; (b) classification of products at the multilateral level within the context of the uniform import tariff; and (c) the standardization and joint or uniform application of legislation on the protection of industrial property, animal and plant sanitation and standards of hygiene for manufactured products.

(a) Certificate of origin

Article V of the General Treaty states that "the Executive Council shall lay down regulations governing the procedure to be followed in determining the origin of goods". The Council has examined the question on various occasions and has decided to postpone the adoption of regulations until it has gained some experience in the matter. Meanwhile, it has provided that any cases that might arise should be treated on an ad hoc basis and studies should be carried out on the rules of origin that might be applied to specific products of immediate and vital importance in respect of Central America's industrial development.<sup>3/</sup>

On the whole, the determination of the origin of goods has not yet presented any serious difficulties in practice. Since the authorities have adopted a broadminded and flexible approach to the question, the number of doubtful cases that have arisen are relatively few. They have nearly all been solved on a bilateral basis and only a very small number have had to be referred to the Executive Council. Even so, this has remained a latent common market problem, not only because of the lack of technical and administrative facilities at the country and Central American level, but also because it leaves room for manipulation which might limit free trade.

The best course would be to continue to treat questions of origin as broadmindedly and flexibly as hitherto, and to maintain the present procedure involving ad hoc decisions or verdicts of the Executive Council.

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<sup>3/</sup> The Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA) is engaged in preparing draft regulations governing the origin of goods.

It should be recognized that, in view of the as yet incipient development of Central America's industrial development process, simple and minimal criteria should be adopted in order to avoid limitations and obstructions that might be detrimental to intra-area trade.

As part of this general approach, the latent problem in question might be solved by instituting a special procedure of an optional rather than compulsory nature, i.e., certificates of origin would be issued for particular products at the express request of the interested producers. Another measure might be for the integration bodies to complete the schedule of products of Central American origin and place it at the disposal of the national and regional authorities.

On the other hand, it would be best if the national economic integration officials were assigned the task of solving the problems arising in each country in relation to the origin of products. Such a task would not necessarily be either too costly or too technically complicated, since in general even a simple but thorough inspection - for example, of agricultural commodities whose origin is more difficult to determine - would do much to prevent these disputes.

(b) Customs tariff classification

In article XI of the Central American Agreement on the Equalization of Import Duties and Charges, the Central American Trade Commission - now the Executive Council - is instructed to study the maintenance of uniformity in the application of the Standard Central American Tariff Nomenclature (NAUCA) and to make appropriate recommendations. Time, experience and the very growth of domestic production and foreign trade have brought into focus the need to revise and modernize this instrument - which was formulated over ten years ago -, in order to satisfy new needs, facilitate the uniform application of the common tariff and bring the nomenclature into line with the advances meanwhile achieved in other countries.

Consideration should likewise be given to another special procedure, similar to the one suggested for the certificate of origin, but relating to the customs tariff classification. It would serve to determine at the regional level - for the five countries concerned - and at the interested party's request, the tariff group in which specific products should be

classified under the common tariff. This classification would reinforce the existing practice of consultations with SIECA and would be applied not only in the case of a regional producer or a particular shipment, but in general to the product itself independently of its origin. This would help to make the tariff differential with respect to imports really operative and to ensure the continuity of free trade in the Central American item within the common market.

Both the tariff classification of products at the Central American level and the issue of certificates of origin could be handled by the Executive Council and be made mandatory for all border customs officials. Administratively speaking, in accordance with article XXIV of the General Treaty, SIECA could delegate this function, except in cases of controversy, which would be submitted to the Council.

If these instruments are to be adopted it will be necessary to formulate specific procedures for the classification of merchandise in accordance with the standard tariff nomenclature <sup>4/</sup> and for determining its origin. At the same time, their use in practice would call for the formation of technical cadres in SIECA and ICAITI, it being necessary in both cases to establish connexions with the appropriate specialized foreign institutions.

(c) Protection of industrial property

The national laws for protecting industrial property - trade marks and trade names - which are also applied at the national level within the context of the common market, enable firms in a given country manufacturing products under the import substitution programme to register under their own names competitive trade marks originating from other member countries. Fortunately, this is not a widespread practice in Central America, but it has had noticeably adverse effects on the flexibility and growth of intra-area trade flows and on the general measure of confidence placed in integration by trade and industrial sectors.

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<sup>4/</sup> The Standard Central American Customs Code and its regulations oblige the national authorities to refer to SIECA the tariff classifications which have been the subject of appeal at the national level.

These problems have been a source of concern to entrepreneurs and officials practically since the common market was established. Their solution requires a Central American agreement on the protection of industrial property, under which the main provisions of national laws would be standardized and modernized, and rules and procedures would be established at the regional level for dealing with situations that go beyond the limits of any one country. SIECA has done some work in this direction and has prepared a project which should be examined - together with all the data accumulated - by an inter-governmental working group with a view to formulating a draft agreement for submission to the Executive Council and the Central American Economic Council for approval and signature.

(d) Health regulations

As regards quarantine and other health standards and regulations, experience has shown that their application by the national authorities might come to interfere with free trade for reasons unrelated to pest and disease control or public health protection. It would seem advisable, therefore, to adopt standard legislation on animal and plant sanitation and standards of hygiene for industrial products, and to apply it, as far as possible, entirely at a regional level. The Agricultural Development Sub-Committee adopted this position regarding the former issue at its first meeting, requesting the Central American Phytosanitary Organization (Organismo Internacional Regional de Sanidad Agropecuaria - OIRSA) and SIECA to prepare the preliminary work required.

The Economic Council duly adopted a resolution directing ICAITI to prepare the industrial standards concerned. This provision should be supported by the necessary legislation in order to avoid duplication of functions between ICAITI and other authorities, as happens at present. Thus, for example, ICAITI would establish the industrial standard for a specific product, which would include the technical standards of hygiene imposed by the national or international public health authorities.

The inclusion of these measures in Central America's radius of action should be a relatively simple task. Yet they would help not a little in protecting free trade from the arbitrary application of that

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type of provision and, in general, in strengthening the atmosphere of security and confidence in respect of common market operations. It might also be conducive to important new institutional advances in economic integration, in addition to increasing the efficiency and the sphere of action of existing bodies - such as OIRSA and ICAITI - and improving the technical and administrative nature of the functions carried out in each country.

### 3. Customs tariff policy

#### (a) Customs tariff legislation

The need to prepare standard tariff legislation that would facilitate the application of the common import tariff - also on a uniform basis in the five countries concerned - had been recognized for some years. Subsequently, in article XIX of the San José Protocol to the Central American Agreement on the Equalization of Import Duties and Charges, the Governments decided to undertake this task and to sign an agreement on the question.

The work done since then has made for considerable progress, as crystallized in the Standard Central American Customs Code, with respect to containers, ranges of samples and trade samples, average, special trade transactions, etc. Nevertheless, Central America has not yet standardized its tariff legislation, nor has the above-mentioned agreement been signed or even drafted.

Much could be done in that direction by revising the Standard Central American Customs Nomenclature (NAUCA) and by incorporating the appropriate Manual in the standard legislation, as a basis for the classification and level of aggregation of tariff items. It would be necessary to establish common basic principles for the valuation of imports, not only to facilitate the uniform application of the tariff, but also to combat the practice of undervaluation and to eliminate the effects of discriminatory sales and trade policies governing exports to the region that might be applied by third countries.

It would also be necessary to formulate provisions concerning other questions, i.e., reductions in uniform import duties and charges and procedures for applying them, and tariff treatment proper for NAUCA items

/involving special

involving special transactions and securities. A first step to that end would be to prepare some technical studies and to make use of the experience accumulated by other countries and institutions, such as the Brussels Customs Co-operation Council, the Brussels Tariff Nomenclature, the Latin American Free-Trade Association (ALALC) and the General Agreement on Tariffs and Trade (GATT).

It should be pointed out that the standard tariff legislation - once in force -, besides contributing to the uniform application of the common import tariff, might well facilitate the execution and control of other elements of Central American economic policy, e.g., exemptions granted under the Central American Agreement on Fiscal Incentives to Industrial Development, protective measures against unfair trade practices and, in general, various aspects of regional trade policy with respect to third countries.

(b) Flexibility of customs tariff

Although the uniform application of the common import tariff is so important, it should be recognized that the basic problem in relation to tariff equalization is at present the need to establish more flexible procedures for modifying the uniform import duties and charges, in line with the changing conditions gradually emerging as a result of the economic development itself. So far this has been the problem of most concern to Governments as regards the operation of the common market, because of the long time it usually takes to renegotiate the said import duties and for the new duties and charges to enter into force.

This want of flexibility seems to have been a critical feature hitherto, mainly in relation to that aspect of tariff policy which concerns the protection of Central America's industries. The contention is that under the existing provisions it is not unlikely that the enterprises requiring this protection will receive it too late, if indeed they receive it at all, and that the difficulty lies in the process of ratification by the legislative body. It is therefore proposed that this requirement should be eliminated in all future protocols to the Central American Agreement on the Equalization of Import Duties and Charges in relation to the renegotiation of the uniform import duties already agreed upon.

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However, Central American experience shows that the slowness in renegotiating import duties is not attributable only to congressional formalities. There are also delays - and even longer ones - at other stages, specifically (a) between signature of the relevant protocols and their presentation to the legislative body, and (b) between ratification by the latter and the date of deposit of the relevant instrument.

These delays, in turn, are not always due to the inflexible nature of the equalization procedures, but also partly to the backlog of work on the Executive Council's agenda - owing to its present limited facilities - and partly to different unrelated problems chiefly connected with other questions, such as, the inter-country balance of development and specific industrial policy questions. Thus, it is quite clear that in these cases the solution to the problem is not dependent upon tariff measures, but upon other circumstances which have not yet been given due priority. Other crucial factors besides those concerning the protection of industry should be dealt with in relation to the common tariff, e.g., its effects on government revenue, the balance of payments and the consumers' well-being.

It would seem advisable, therefore, to act on the principle that uniform import duties should not be altered too abruptly, and that any necessary adjustments should be effected in line with well-known specific procedures. There are two different considerations justifying this view. In the first place, if it is sought to secure the backing of the five States to ensure that production activities can enjoy a certain measure of protection, it should be demonstrated and proved that there are authentic grounds for granting such protection. Secondly, now that procedures and channels of access to tariff policy processes have been altered, it is only fair that any States that might be affected should be given the opportunity of presenting their own points of view, in accordance with procedures established for the purpose.

Thus, it would be advisable to modernize the procedures used until recently in each country and to supplement those now in use at a regional level, steps being taken to specify the various research processes entailed in the renegotiation of tariffs, and the deadlines within which the different stages of renegotiation should be completed. Such periods could

/comprise, for



comprise, for example, (a) the interval between formal presentation of the request and its consideration by the Executive Council; (b) the time taken by the Executive Council to consider and adopt a decision concerning the request; (c) the interval between conclusion of the renegotiation and the signature of the relevant protocol to the Agreement on the Equalization of Import Duties and Charges; (d) the period between signature of the protocol and its presentation to the legislative body; and (e) the interval between ratification by that body and the date of deposit of the relevant instrument by each Government.

As regards action by the legislative body, there appears to be no good reason why the congresses cannot so adapt their internal rules of procedure as to give priority to the protocols, even over and above the formalities and procedures laid down for other cases. It would also be useful if the Executive Council could maintain close contact with the respective legislative committees, not only to keep them informed of progress in these matters, but also, in general, to encourage them to take an active part, within their own sphere of action, in the economic integration process.

The Executive Council has been considering these problems for over two years, focusing attention primarily on the criteria that should be available for renegotiations. Some headway has already been made in this direction with the assistance of SIECA. Another useful measure would be to differentiate clearly between the consultative and information function of private interests in the work of renegotiation - as in that related essentially to different industrial policy questions -, and the deliberative and executive function of the public organs of the General Treaty. In addition to the appropriate internal measures adopted by the Council - for example, the establishment of a working group for the exclusive purpose of renegotiating tariffs -, a contributing factor would be the reinforcement of existing regional procedures, including the channelling of requests for negotiation through SIECA and periodical public interviews to determine the interested parties' view.

/These provisions

These provisions should suffice in most cases to make the common import tariff more flexible, without undermining its necessary stability. Other temporary procedures might be required, however, since action at the present stage of tariff equalization might not be sufficiently expeditious under the general regulations. A fact which should not be overlooked is that, during the equalization process, the uniform import duties and charges were based on five different tariff policies and, in some cases, on inadequate economic data. In these circumstances it might so happen - and indeed has happened on occasion - that the entry into force of specific tariffs has a detrimental effect on certain production activities or even jeopardizes their chances of survival.

In order to remedy these situations promptly, the Executive Council and the First Session of Ministers of Economic Affairs and Finance decided that a protocol to the Agreement on Equalization of Import Duties and Charges should be prepared authorizing the Executive in each State to alter the uniform duties and charges within certain limits and to put the new levels into effect without the necessity of ratification by the legislative body, on the basis solely of the decisions adopted in the matter by the Central American Economic Council. Thus, the constitutional aspect of the delegation of legislative powers would be safeguarded and an effective procedure established for duly amending the tariff.

It would be best to establish this instrument on a temporary basis with a view to adapting the uniform tariff negotiated five years ago to the new conditions of competitiveness and the level of industrial development attained by the common market. After the situation has been remedied and a reasonable period has elapsed - about two or three years -, it would no longer be necessary to maintain this special procedure provided that, from the standpoint of industrial development, the changes in economic conditions requiring modifications in the tariffs would also take place gradually.

Following this period, the general provisions would once again be fully applied, as regards the part played by the national legislative bodies in ratifying each additional tariff equalization protocol, or by the Central American legislative machinery that might in the meantime be established. The need for such machinery is making itself increasingly felt, since if

/the import

the import tariff is to maintain its uniformity in the future it would be awkward if one or more of the national legislative bodies failed to approve the import duties and charges agreed upon by the Executives of the five Governments.

4. Régimes governing exemptions from free trade and items awaiting tariff equalization

The efficient operation and handling of free trade and tariff equalization will greatly facilitate the task of bringing the free-trade area and the common tariff into full operation. It is important to abolish the temporary restrictions on free trade in goods and to eliminate tariff differentials in the case of tariffs that are still governed by domestic legislation, if the region is to make any progress towards economic unity.

(a) Free trade restrictions

Although the General Treaty provides for the automatic elimination of most free trade restrictions, in certain cases recourse will have to be had to other measures. The transition period was established precisely to facilitate the adaptation of existing industries to the new market conditions, so that headway could be made in the specialization of production by plants and in the adoption of larger scales of operation, in conjunction with new investments, the integration of industries and the modernization of their equipment. The difficulty lies in the want of financial capacity, technological experience and organizational ability, and in the fact that these factors do not come about automatically as the result of trade liberalization; the available facilities must be co-ordinated at a regional level and others developed by means of new economic policy instruments.

If the above adjustments are postponed, the liberalization of other items might be adversely affect after various production activities which have been operating on the basis of idle capacity and duplication of facilities, and which moreover, are beginning to face competition from foreign investment within the context of the common market. On the other hand, the difficulties arising with respect to the main agricultural commodities show that it is sometimes impossible to establish free trade

/on efficient

on efficient lines when other requirements are not met, in this case the uniform measures governing minimum prices, financing and storage, which contribute to a systematic distribution of these commodities.

The easing of temporary restrictions to the point where complete liberalization is reached should continue unhampered, as laid down in annex A of the General Treaty. From the above comments it will be concluded that such provisions should be supplemented by a number of tariff, technical and financial measures - as actually laid down in the General Treaty for specific items - in which liberalization will depend upon the equalization of import duties and charges or the promotion of special agreements and the establishment of regulations governing them.

(b) Import duties and charges awaiting equalization

If complete coverage is to be achieved for the common tariff levied on imports from the rest of the world, additional economic policy measures must be adopted at the Central American level. There are several cases in point. Some of the items awaiting equalization are very important from the standpoint of their contribution to government revenue. In these cases, therefore, equalization might well depend on the creation of efficient and flexible reciprocal machinery, consistent with the different countries' fiscal interests.

In other cases, trade liberalization is dependent upon tariff equalization. When this is achieved, several industries which are now being set up with a view to supplying the common market - some durable consumer goods, for example - will directly benefit. The obstacles to determining uniform import duties and charges for these items are related to balanced growth among countries, to the possibilities of survival of specific production activities in some of the member countries under the competitive conditions that would prevail as a result of trade liberalization, and to the extent to which the regional sources of supply would come to replace the items traditionally imported from other countries. Petroleum and petroleum products are a typical example of this: the difficulties encountered in the equalization of customs duties and charges on these imports stem partly from the uncertainty concerning the conditions under which the many refineries established in recent years can satisfy Central American demand as regards price, regularity of supply and quality.

##### 5. Organization of inter-Central American trade

Economic integration has given rise to the need to organize trade and the distribution of products in each country on somewhat different and broader lines in order to build up and consolidate the flow of goods between them, to facilitate the exceptional growth and rapid diversification of trade in the last few years and to promote its future expansion. In the early stages, this project evolved within the framework of the established systems, in response to the initial stimulus provided by the institution of the Central American free-trade area. But as production activities develop within the framework of the common market, needs are beginning to emerge that require over and above the expansion of such systems, a gradual and clearer distinction between the production and the marketing and distribution phases proper, as well as their modernization and the improvement of their techniques.

In general, the point of departure has been a structure of production in which these functions were very roughly demarcated, as compared with those of other countries at a relatively more advanced stage of development. In the normal course of events, a somewhat limited use has been made of up-to-date methods for promoting markets. Knowledge of the characteristics and geographical scope of demand has gradually improved over the years in the light of direct experience, and distribution margins - commission and discount rates, and credit facilities and terms - have been established in the light of the existing level of competition, within the limits imposed by the shortage of working capital.

It is therefore a system adapted to the characteristics of a production base at an incipient stage of development and to the limited possibilities offered by the domestic markets, where there is little room for expansion, modernization or differentiation in respect of the above-mentioned functions. These are precisely the features that are changing with the establishment of the common market and which have brought about some modification of the marketing systems. However, it must be recognized that such changes have not reached major proportions in Central America, because of the short span since the common market came into being and the small volume of intra-regional trade - from 15 to 30 per cent of the total output of a

/typical exporting

typical exporting concern. That is why in this type of industry - which generally produces processed foodstuffs, clothing and containers - distribution is still effected through the individual agent, who is nearly always a trusted employee of the enterprise concerned, through whom it is possible to acquire in advance practical knowledge of the new markets potentially available.

However, the fact that the products in question are frequently the same as those manufactured in nearly all the Central American countries has wrought an immediate change in the previously existing conditions. More intensive competition has often made it necessary to increase the credit facilities granted to distributors and, in general, to raise the working capital. The particular features temporarily characterizing the Central American market - a physically and technically limited production machinery, keener competition and a far from perfect knowledge of regional demand - have, in their turn, prompted certain firms to diversify the structure of their production still further, increasing the range and number of types of products, in an effort to meet the new conditions.

Other changes, of relatively minor importance as yet, have also taken place. Those enterprises which have been able to increase production rapidly with an eye to the common market, and even recently to expand their installed capacity, use either an individual - and sometimes independent - agent or a reputable local distributor. They are enterprises which, in view of their size and economic capacity, undertake or arrange for the carrying out of small-scale market studies, and can expand and improve their internal or external credit facilities.

Lastly, there are enterprises that have been set up recently with a view to supplying the common market exclusively at a regional level, and whose exports to the rest of Central America represent 80 per cent or more of their total production. Such concerns invariably use their own permanent representatives or distributors in these markets. This course of action, however, is not primarily dictated by their relatively large volume of exports, nor by their scale of production or the size of the Central American market. They are mostly subsidiary branches of foreign concerns which possess a huge sales organization and a considerable financial

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capacity, or which, as traditional exporters to Central America, use the national distribution system they had already established in each country.

The trade organization that would have to be developed as manufacturing increases and changes, will probably tend to be based on an independent and broader system of distribution with recourse to more up-to-date techniques. Industrial concerns in general will hardly be able to establish their own distribution organizations - as an alternative measure -, both because of the high investment in equipment and the substantial expenditure on labour that this would entail, and because they would find it difficult to meet the complex organizational requirements involved.

Thus, a further limiting factor is the relatively small number of wholesale distributing firms in Central America with up-to-date organization and techniques. The industrial producer is therefore confronted with a narrow range of possibilities for channelling his output, with the consequent disadvantages as regards the distribution and discount margins he has to grant, and the difficulty of controlling the final price of his products and of recovering his expenditure and investment.

Little has been done so far within the context of economic integration to study and solve these problems. It would be advisable to go more deeply into their various aspects; to begin with, the more widespread practices and formulas should be carefully examined and, on that basis, specific public or government measures should be adopted with the purpose of (a) adapting credit policy, strengthening the facilities recently created and co-ordinating the terms under which the working capital of industrial enterprises and the firms exporting their products is financed; (b) promoting the modernization of marketing and distribution services; and (c) providing specific technical assistance of a pragmatic character to facilitate research and the acquisition of a fuller knowledge of the regional market, and modernizing and improving existing trade practices and techniques.

#### 6. Competition in the free-trade area

Generally speaking, the opening up of the five Central American countries to free intra-area trade has served to improve competition. The first manifestations of an entrepreneurial dynamism and initiative hitherto lacking in the area have begun to be noticed and, if reinforced, would stimulate the development of investment capacity and project implementation, thereby helping to make full use of the opportunities offered by the common market. This has helped to create reasonably satisfactory conditions in relation to the supply of regional demand for consumer goods as regards volume and quality, although, for want of studies on the subject, the evolution of prices in relation to those prevailing prior to economic integration cannot yet be determined.

Certain problems have emerged, however. In the case of some intermediate products and raw materials of Central American origin, the existing conditions - as in the early stages of industrial development in other countries - apparently leave something to be desired with respect to quality and the regularity and promptness of supply at the regional level. This, in general, reflects technical shortcomings in regard to quality control, flaws in the specifications, deficiencies in the transport system and, in several cases, insufficient stocks and inadequate estimates of future demand by the producers. When such conditions are combined with a protectionist policy limiting imports from outside the area - whether through the import tariff or through failure to grant tax exemption - this tends to have an adverse effect on the manufacturing processes of the industries using such materials and, therefore, on the quality of the finished product.

Likewise, since the common market was first in operation, there have been signs of a marked tendency on the part of producers to enter into agreements which were designed to limit competition in the region and favoured neither price reductions nor quality and other improvements on the supply side. Such agreements, inasmuch as they entirely eliminated competition, sometimes resulted in the complete disappearance of trade flows of specific products between countries. In other cases, they evidently permitted exports of some types of a given product and not others,

/in exchange



in exchange for reciprocal treatment from producers in the rest of the Central American countries. Initial studies on the situation prevailing in other industries indicate the existence of additional procedures which relate to agreements on price levels, and even on market distribution based on the quota system.

The Central American Economic Co-operation Committee, at its third special session for the first time focussed attention on these problems. Considering that the arrangements aimed at limiting competition and restricting inter-Central American trade were contrary to the aims of economic integration, it decided (see resolution 115 (CCE)) to formulate a draft protocol to the General Treaty defining restrictive practices and establishing the sanctions to be applied when such practices were found to exist, and to that end requested SIECA and ECLA to undertake the necessary studies.

Since then attention has been drawn to the need for a legal instrument that would help to ensure a reasonably competitive climate within the context of regional economic unity. At the same time, it has been concluded that, in order to define the radius of action of such an instrument, its structure should be based on a fuller knowledge of Central American economic processes and, moreover, that it should be supplemented by various technical, legal and financial measures.

In the more advanced countries, monopolistic tendencies are generally noted in dynamic and highly capital-intensive industries involving complex techniques, whose production is designed to satisfy a huge demand by virtue of the size and income level of the consumers. Hence the relatively small number of enterprises and the difficulty encountered by newly competing concerns in gaining access to these spheres of activity. This explains the above-mentioned agreements for regulating prices and supplies, although vigorous competition is often maintained between such enterprises, based on other factors, e.g., sales promotion, the opening-up of new markets, diversification and improvement of their products and, above all, intensive and costly scientific research.

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On the other hand, none of these conditions is a determinant of the restrictive practices instituted in Central America. Since the structure of its industry is based on small plants using outmoded techniques, the root of the problem must be sought in other causes, which derive from the increase in the number of competing units in one market thanks to the establishment of the Central American free-trade area. In all probability that increase has come to upset the equilibrium reached in each country as a result of the already monopolistic character of some industries at that level, or because all enterprises, despite the small size of their market, could survive economically under the protection they enjoyed.

Thus, the private sector's opposition to free trade largely reflects the producers' first defensive reaction to the intensification of competition, without bringing in its train any general advantages in regard to prices, quality or supply conditions. That reaction is attributable to the fact that, on the one hand, the Central American producers are not prepared to work in that new climate of competition or to effect the necessary adjustments and, on the other, they lack the capacity and means needed to expand their facilities, specialize and improve their techniques in order to compete to advantage under the new conditions.

The above comments may serve to substantiate Central America's recognized need for a regional agreement on this subject and to clarify somewhat the questions related to the type of measures that could best be included in the agreement in order effectively to combat the above practices. In some of the industrialized countries - the United States, for example - such measures usually take the form of legal decisions designed to prevent the absorption of new enterprises by larger concerns, to compel the latter to break up into smaller independent enterprises, or to force them to give up the control they exercise over other concerns through the sale of a proportion of their shares. None of these measures are warranted in the case of Central America's industries, since there are no enterprises of that kind in the area, nor do the situations requiring remedy derive from the same kind of factors.<sup>5/</sup>

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<sup>5/</sup> It might, however, be as well to consider the adoption of some of these procedures in cases where Central American enterprises are absorbed by foreign concerns, when this runs counter to the regional interest.

Be that as it may, the matter is a complex one because such instruments, in addition to being efficacious, viable and easy to handle, should be compatible with flexible trade flows and the common import tariff, besides adequately safeguarding the legitimate interests at stake. The first step would be to consider the possibility of restoring and promoting competition in the common market through the handling of imports. This could be achieved (a) through the temporary or permanent reduction - as the case might be - of the tariff protection enjoyed by the industries concerned; (b) through authorization to import the same products subject to the payment of import duties and charges lower than those now in force, so long as the restrictive practice of competition subsists; or (c) by revoking or abolishing the exemptions granted in accordance with the agreement on uniform tax incentives to industrial development.

This type of measure does not seem difficult to apply under conditions involving the continuing uniformity of tariff equalization, since the restrictive practices correspond in most cases to agreements to which nearly all the producers in the industry in question are parties. Such measures would have the added advantage of not depending upon cumbersome legal formalities in so far as their application is concerned. Once the relevant protocol to the General Treaty was in force, they could be implemented through administrative procedures that would gain much in simplicity without loss of equity.

In formulating the protocol, more serious difficulties might well be encountered in regard to the legal definition of the practices to be corrected, and to the legal view of the economic situations that have given rise to them. The intention is to intensify competition not as an end in itself, but as a means of boosting the development, specialization and modernization of production within the framework of the common market. The creation of a climate of destructive competition could be as detrimental as its total absence.

Accordingly, it is attempted through the institution of the above-mentioned legal provisions to inject into these questions a consideration of a public nature and to avoid limitations on competition being established merely as the result of the monopolistic character of particular industries.

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But in cases where such limitations arise for want of adequate means to adjust to the conditions created by integration, those provisions should establish reasonable periods for the cancellation of the private agreements in force and be supplemented by measures of another kind - technical, financial, fiscal and legal - that would supply those means and facilitate the required economic adjustments.

It should be borne in mind that the problem dwelt on in these comments constitutes an exception to the general rule in the Central American common market and that most of the situations in which it is manifest today are probably only temporary, in that they will tend to disappear as the production process develops. Hence the expansion, specialization and modernization programmes at a regional level in respect of established industries, constitute an important basis for finding a real final solution to the problem.

This does not mean that the protocol to the General Treaty would be unnecessary or would lose its effectiveness once the existing problems were solved. On the contrary, such an agreement seems essential not only to stimulate the growth and transformation of the five countries' industrial economy, but also to correct certain practices which are alien to that development process and can be explained only in terms of the unlimited economic power of certain interests. In view of the technical and economic characteristics of present-day production activities and the relatively limited size of the common market, the monopolistic tendencies are likely to become a chronic feature in Central America.

#### 7. The harmonization of fiscal systems

##### (a) Background data

In line with the guidelines established by the Central American Economic Co-operation Committee, the ECLA secretariat prepared a study <sup>6/</sup> in 1965 in which, for the first time, the five countries' tax systems were examined systematically on a comparative basis and the main problems were identified. In 1964-65 the Organization of American States (OAS) and

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<sup>6/</sup> See La política tributaria y el desarrollo económico de Centroamérica, United Nations publication, Sales No.: 1957.II.G.9.

the Inter-American Development Bank (IDB) prepared detailed studies on the tax structure in each country, a brief version of which was presented at the First Meeting of Central American Ministers of Economic Affairs and Finance.<sup>7/</sup> This meeting laid down broad outlines for the studies of regional scope to be carried out in the future with the assistance of an Advisory Committee composed of various Central American and international agencies.

At the same time, the first steps have been taken to determine the requirements that would arise in this field from the common market movement, with a view to postulating, as a prior requisite for tax reform, a harmonization of the national systems, which would lead to: (a) neutralizing their influence on the location of production activities in one country or another; (b) obtaining the necessary financing for public expenditure, in the light of its growing needs and of the supplementary role that external credit will be called upon to play; and (c) promoting investment in production in order to boost the area's economic development.

All this constitutes a preliminary frame of reference. What is required now is an analysis of the specific tax problems that have emerged in Central America in relation to the establishment and entry into force of the common market. This analysis is important in order, on the one hand, to define the integration aspects in the whole group of questions requiring government action in this field, and, on the other, to arrange them in order of priority for the purpose of organizing the proposed studies.

(b) The fiscal problem vis-à-vis the common market

The need for regional co-ordination of certain aspects of domestic tax systems is not due in Central America to major differences in those systems which might adversely affect the flexibility of trade flows, the uniformity of tariff equalization or the pattern for the location of investment. On the contrary, the five systems - although different in certain respects - are basically similar in the initial phases of integration. In this connexion, the situation differs from that of other economic co-operation movements in more advanced countries, whose tax systems had to be brought into line because the disparities between them were far greater.

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<sup>7/</sup> See Resumen preliminar de conclusiones y recomendaciones sobre reformas tributarias en Centroamérica.

In Central America it is a question rather of changing the existing tax structures in order to make up for the weakening of the traditional sources of income and to meet the growing needs in respect of financing economic development. In this reform process, which has already been initiated in the countries of the area with the creation or modification of certain internal taxes, new factors are emerging as an immediate result of the integration action adopted. On the one hand, unilateral government action might aggravate the existing disparities between countries in regard to taxation. On the other hand, each Government, acting on its own, will try to avoid changes in the tax system that would limit their exports to the rest of the common market or tend to divert investment towards the other member countries. This would make the handling of the public finance still less flexible and, given the impossibility of the unilateral manipulation of the import tariff, might obstruct the implementation of short-term fiscal policy and delay reforms of larger scope of the kind outlined in the above-mentioned studies. This applies, for example, to direct taxes in which none of the countries can be expected at this stage to make substantive changes in the way of appreciable increases in the taxes levied on income and profits, unless the other members of the common market do likewise.

Here, as in the area of indirect taxes - where shorter-term measures might be required - it would seem advisable to strengthen the five countries' joint effort in respect of co-ordinated study, negotiation and decisions. This would be a new and permanent integration activity of general scope, designed gradually to bring into line the principal aspects of the tax systems and to facilitate public sector financing in each individual country. The full results of this activity would not be noted immediately, although several questions might be solved in the near future.

(c). Import revenue

Import duties have always been the main source of revenue for the Central American Governments. A great deal has been said concerning the disadvantages of a tax structure of this kind, in view of the Treasury's vulnerable position in the event of foreign trade fluctuations. It should be recognized, however, that such a structure is the result not of arbitrary

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decisions but of the traditional development pattern of the export agriculture economy, the scant diversification of the production system and the existing distribution of wealth and income.

As a result of the economic development and integration policy, this source of revenue has been gradually weakened, in relative terms, during the last few years, while its characteristic instability has remained unaltered, since it is based, in general, on the trends followed by the capacity to import generated by exports. This weakening trend began in a period - 1961-64 - of recovery in the external sector and, therefore, revenue has not actually declined or remained at a standstill, but has increased more slowly in relation to the rapid growth of total imports.

On the one hand, this reflects an incipient change in the composition of imports, inasmuch as external purchases of goods upon which relatively low duties are levied - machinery, equipment and raw materials - are increasing faster than those of other products subject to protectionist taxes, e.g., durable and non-durable consumer goods. On the other hand, the more rapid expansion of duty-free imports from the area has also had some effect.

In the light of experience in other countries, the weakening of foreign trade - in particular of imports as a source of revenue - might be considered the beginning of a lasting situation in Central America, which will become worse as time goes on. However, this would not be exactly the case if it is assumed that, over the long term, Central America's growth would have to continue to be based on an outward-directed development model, although with a more diversified structure of production which would be established as a result of regional economic integration. Accordingly, if development is not founded exclusively on import substitution, both external purchases and exports could increase at a pace equal to or faster than the growth rate of the economy as a whole. Hence, foreign trade could well continue to be a productive source of revenue.

There might even be changes, due to other considerations, in the procedures for collecting such revenue, i.e., it might come to depend less on customs duties than on direct taxes and the general sales and consumption

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taxes. But this might happen without decisively affecting the fiscal value of imports, if these continued to include a considerable proportion of consumer goods as a result of failure to complete import substitution in respect of those goods, as in the case of other Latin American countries. In these circumstances, continued emphasis on the taxation of external purchases would also be justified, not only for administrative reasons, but as a means of giving further protection to Central America's production for the common market and of mitigating the regressive effects of the income distribution structure, since most imported goods are consumed by the wealthiest population groups.

If consideration is given to the short or medium term, it is quite clear that customs duties are, and will continue to be, one of the main sources of revenue in Central America. This partly explains the difficulties encountered during the last few years in bringing the common tariff into full operation. The items awaiting equalization, although only a few, are the most important as regards revenue. Therefore, since there are no regional procedures ensuring effective and expeditious action, the Governments have not considered it wise to lose the flexibility with which they can, at their own discretion, change the tariffs applicable to non-equalized items as consistent with each individual country's needs.

Accordingly, the possibility of establishing uniform tariffs for such items is closely dependent upon the adoption of new measures designed to give the common import tariff the greater flexibility it needs. This, however, would not suffice. It seems essential, too, to introduce reforms in the tariff renegotiation procedures. During the last few years, the concept of industrial development has tended to take precedence over others in the renegotiation, and the general considerations on the effectiveness of the customs tariff as a whole, from the fiscal standpoint, has been relegated to second place.

While not ignoring the procedures in force or the industrial policy considerations, it would be wise to undertake a periodical examination and over-all review of the tariff in order to restore its validity or operational effectiveness from the tax angle, as this is consistent with the aim of seeking co-ordinated solutions to the tax problems confronting the five

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Governments. This examination and over-all review could be carried out jointly by the Executive Council and Ministry of Finance officials, in accordance with the guidelines laid down by the Meeting of Central American Ministers of Economic Affairs and Finance.

The Executive Council could also embark, in the near future, on a review of tariff policy as applicable to specific capital goods, intermediate products and raw materials - in respect of which there are low uniform tariffs in force - with a view to exploring the possibilities they offer from the tax standpoint. This question was raised some time ago by the Central American Trade Sub-Committee in relation to certain regional trade policy issues, the aim being to strengthen Central America's powers of negotiation vis-à-vis third countries.

The adoption of measures such as those suggested here would not tend to discourage the development of production activities of interest to the common market, inasmuch as those activities could be promoted through the establishment of uniform tax incentives. In this respect, such a change in tariff policy is more likely to result in a sound use of tax exemption as an instrument for guiding the development of production activities in the area, and in increasing its effectiveness in encouraging or discouraging these activities, as the case might be, and in line with the requirements of balanced dynamic structure of manufacturing.

Lastly, a difficult problem, the study and solution of which should not be postponed for too long, is the high proportion of imports entering Central America from the rest of the world under the protection of tariff concessions, and the consequent need to establish regulations governing this activity and to bring the relevant legislation into line at the Central American level, in order to reduce the loss in taxes and to prevent equalization and the actual tariff and industrial policy aims from being vitiated. Very provisional studies for 1962 indicate that the proportion of imports exempt from customs duties fluctuated, from country to country, at between 20 and 30 per cent of total imports, and represented equal proportions of the losses in taxes in relation to the total theoretical tax collections.

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This has been a matter of concern to Governments ever since the Multilateral Treaty on Free Trade and Central American Economic Integration was being negotiated and a preliminary version prepared. In article V of this instrument and article IX of the General Treaty, specific provisions were introduced to protect Central American production from the adverse effects it might suffer through the use of tariff concessions.<sup>8/</sup> On the other hand, in article VII of the Agreement on the Régime for Central American Integration Industries, the Governments undertook not to grant customs duty exemptions or reductions on any imports of goods which were equal or similar to or substitutes for goods manufactured by plants of industrial integration industries.

None the less, it should be recognized that, in so far as its fiscal implications are concerned, the problem has not yet been satisfactorily solved. The establishment of uniform incentives to industrial development was a step in the right direction, but available figures show - for 1962 also - that the exemptions under this head represented barely one-third of the total value of the customs duty exemptions and reductions granted by the five countries.

It would be desirable to complete and bring up to date the information on this subject, and to make a compilation and a comparative examination of the domestic legislation in force. Once the relevant studies had been carried out by the Governments, with the assistance of SIECA, the Executive Council and the Ministries of Finance, there would be a point of departure, first of all, for establishing the minimum uniform criteria for administering that legislation and then - after a reasonable period of experimentation and testing of their efficacy and viability - for formulating a Central American agreement that could at least curtail tax losses and prevent vitiation of the equalization agreements and the actual development policy aims.

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<sup>8/</sup> In compliance with article IX of the General Treaty, the Executive Council has adopted a number of resolutions prohibiting or standardizing the granting of customs exemptions or reductions in respect of imports of specific items, on the basis of requests from the interested countries. It has further provided that countries should exchange all available information concerning the production of raw materials, semi-manufactured products and containers.

(d) Taxes on consumption

In the face of the problems and needs outlined above, steps have already been taken to revise the domestic tax structures by introducing sales and consumption taxes. These have been established along the lines laid down in article VI of the General Treaty, which is intended to create a compensating mechanism designed, in practice, to avoid restrictions on the effective liberalization of trade.

Little need be said, for the moment, on this aspect of the fiscal issue in integration, since the effectiveness and flexibility of free trade flows are safeguarded by the fact that taxes on consumption are collected in the country of destination of the goods, are also levied on the domestic production of the article in question, and are not applied, unless the Executive Council so authorizes, when the article is not produced in one signatory State but is produced in any or all of the others. Experience shows, however, that it would be advisable to lay down regulations for the implementation of article VI of the General Treaty, for the dual purpose of establishing uniformity in regard to its interpretation - specifying its sphere of action -, and of making sure that taxation is identically applied in practice to production both from the rest of Central America and in each individual country.

As distinct from tariff questions, where the need to take general tax considerations into account was emphasized, in the case of taxes on consumption more specific criteria would have to be adopted concerning their effects on investment and industrial development. This would preclude the danger of unfavourable repercussions on specific production activities of regional interest, and would remove the incentives, deriving from the application of high import duties for reasons connected with the balance of payments, to set up industries for the manufacture of luxury goods of little use in promoting economic development.

On the other hand, it would be desirable to avoid an undue increase in the number of taxes on consumption of specific products, which should be consolidated in taxes of a general nature, owing not only to considerations of a purely fiscal character but also to the increasing difficulties to which their increasing number would give rise in a process for bringing

/them into

them into line with one another at the Central American level. In addition to the joint studies, negotiations and decisions alluded to above, it would be advisable also to include an examination of the problems and the best way of revising the present tax collection system in the country of destination, against the time when border customs will have to be abolished and a customs union established. It could then be converted into a collection system in the country of origin of the goods or the taxes in question could become sales taxes, for example, or, in certain cases, regional tax collection instruments at a Central American level.

(e) Public expenditure within the context of integration

The fiscal problems stemming from economic integration are not confined purely to the tax angle. As indicated at the First Meeting of Central American Ministers of Economic Affairs and Finance, there are other important questions related to the amount and composition of public expenditure. Many of these questions have yet to be clarified, but it is quite clear already that the government expenditure required to finance the common market and bring it into full operation will necessarily increase substantially, both in expanding and reinforcing its institutions, and in covering, inter alia, the local financing of regional infrastructural programmes. As an initial practical measure - until such time as the necessary basic studies are completed - it would be as well to prepare and keep up to date an integration budget (by country and consolidated for the whole of Central America) containing details of government contributions. The performance budgeting technique could be used, which would make it possible not only to calculate the size of Central America's public financing effort in the common market, but also to evaluate the results in terms of expenditure effected, and perhaps thereby facilitate the action needed to increase and give priority to the countries' contributions in the years to come.

At the same time, on the basis of estimated future needs, it would be advisable to establish permanent sources of tax revenue to finance the Central American institutions - SIECA, BCIE, ICAITI and the Advanced School of Public Administration for Central America (Escuela Superior de Administración Pública de América Central - ESAPAC) -, the Integration Fund and

/other regional

other regional integration instruments. These initial projects, once they had been singled out from the national budgets and, as far as possible, established on the basis of regional taxation procedures, would not only be instrumental in eliminating delays and uncertainties and assuring the financing of these institutions, but they would also be very useful in providing the background for subsequent achievement of an appropriate tax system for a customs union completely Central American in scope. Indeed, these projects would play a similar role to that of the bilateral treaties which in the previous decade, has prepared the ground for trade liberalization in the five countries.

(f) Action mechanisms

The establishment of the Meeting of Central American Ministers of Economic Affairs and Finance as a permanent body, of continuing contact between the Ministers of Finance in connexion with regional matters, and the creation of the Advisory Committee on Taxation constitute the first steps towards effectively promoting the activities reviewed above. If the system is to be improved and the work of the various institutions better co-ordinated, it would be advisable, in addition, to set up a technical committee composed of government officials responsible for tax and budgetary matters in each country.

This technical committee, with the advisory assistance of SIECA, could operate either independently or jointly with the Executive Council, depending on the matter being dealt with; it could also serve as an organ of the Executive Council when the time comes - as no doubt it will - to advocate the Council's reorganization in the interests of more efficient operation. If this suggestion were approved, the Commission could immediately start to analyse and discuss the studies that are already available, examine the problems indicated above and formulate specific recommendations to the Ministers of Finance and to their joint meeting with the Ministers of Economic Affairs, in addition to directing the work of the Advisory Committee on Taxation. It should be recognized from the outset that the intention would be to organize permanent tax procedures designed to achieve the same kind of results as those attained by the Central American Trade Sub-Committee in the formative phases of the legal and institutional framework of the common market.

## 8. Industrial policy

The progress made in Central America's industrial development is having a positive effect. Trade liberalization has served as a catalyst in this process and the entrepreneurial sector has responded dynamically to the new opportunities. The main limitations really consist in the inadequacy of the process as a means of laying the bases for continued satisfactory development of manufacturing. The intention is by no means to slow down the progress now being made, but to make good the deficiencies and reinforce the initial efforts in order to change the pattern of industrial development in the area.

Be that as it may, the need to inject new vigour into the application of Central America's industrial policy is perhaps - after the development policy in the infrastructural sectors - the major and most pressing problem today confronting economic integration. In general, it is not due to the lack of a clear definition of regional aims or of the legal instruments to attain them. The crux of the problem is really the far from vigorous application of those instruments, the failure to adapt them, the lack of co-ordination between the various policy measures and the low standard of Central American technical personnel.

The document entitled Los problemas de la política industrial centroamericana (E/CN.12/CCE/311), presented jointly by SIECA and the ECLA secretariat at the sixth special session of the Economic Council, contained a full account of Central America's industrial strategy, as well as of the method of applying the agreements in force and of co-ordinating the action of the regional institutions. Hence, the present report will merely indicate a number of new problems and to formulate recommendations concerning particular changes that might be introduced in some of the integration agreements and the specific action to be adopted at both the national and the regional level.

### (a) The channelling of resources into industrial development

The prospect of channelling more domestic resources into manufacturing industry by means of price changes were analysed in the first part of this document. From another standpoint, the climate created by tariff, tax

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exemption and liberalization policies has stimulated industrial production, and this has also been helped by the expansion and diversification of the sources of financing.

The use of resources was until recently limited to re-investment of profits in the industrial sector itself and the transfer of savings from the export sector. Now, however, BCIE, IDB and the private financing associations recently established in the area have taken the initial steps towards financing investment. At the same time, BCIE itself has opened credit lines for the financing of working capital, and the national banking institutions have increased their credit facilities for manufacturing production and for exports to the rest of the common market.

This does mean that the question of industrial financing is completely solved. Investment credit facilities should be substantially increased, and the terms for extending short-term loans should be amplified and liberalized, even though it might be necessary to adapt the stabilization policy in order to overcome the limitations imposed by the over-all credit ceilings. It would also be as well to seek other sources of external financing - international agencies and governmental bodies - so as to obtain resources over and above those provided by BCIE for use in industrial investment programmes and projects.

The problem cannot be completely solved without the adoption of supplementary measures aimed at discouraging investment in fields with a low priority in respect of development, e.g., the building of homes by the high-income sectors. It will be noted that the flow of investment into industry depends not only on the incentives offered by this sector but also on the encouragement and stimulus given in other fields.

The channelling of investment into industry calls for the creation of new incentives and a climate of security as well as the machinery for mobilizing private savings at the domestic and regional level. Considerable headway could be made within the short term through the combined action of BCIE and the national development institutes in promoting and directly participating in specific projects and in the implementation of programmes for the tapping of savings.

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On the other hand, to achieve mobility of private savings between countries is a long-term task. It could be done only gradually, as uniform conditions are established favouring investment on solely technical and economic grounds, both in the country in question and in any other part of the common market area. The studies on the establishment of uniform legislation for credit instruments and securities, as well as the studies on bank laws and regulations, and those relating to the uniformity of tax systems, will help to clarify the basic problems and will facilitate some progress over the short term.

Similarly, the modernization of other trade legislation provisions and of the systems governing stock companies might well encourage the setting up of regional enterprises financed by investors in the various member countries. The industrial enterprise is still basically of the family type and, although there are now national groups of investors which operate as a unit, they are still in the minority and no important reciprocal links have been established between groups in more than one country in connexion with specific regional investment projects.

Lastly, the fact that the availability of savings is not always the factor limiting industrial investment should not be overlooked. Often ignorance of the opportunities offered by the common market and lack of technical experience or organization are the real obstacles restraining Central America's initiative.

(b) Policy governing the structure of production in relation to manufactures: the régime governing industries and the special tariff system for the promotion of production

The initial concern in regard to the duplication of investment and other characteristics of industrial development is gradually undergoing a change. It is becoming daily more evident that the advantages of industrial growth on a more competitive basis are, in general, a new feature in the Central American countries, which it would be wise to encourage in order, among other things, to bring down the prices of industrial products paid by the consumer and thus to transfer to the bulk of the population a proportion of the benefits deriving from the creation of a more efficient and rational structure of production.

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But it has also become apparent that special incentives will have to be created for the basic industries, which could hardly develop on their own in view of the characteristics and limitations of the Central American economies. In other words, it seems imperative for Governments and integration agencies to embark on an active promotional campaign in order to ensure the establishment of basic industries on a highly efficient basis, and their most suitable location in terms of technical considerations and the inter-country balance of development.

So far there are very few general or specific instruments for directing the development of the structure of industry from a regional standpoint. Although the uniform tax incentives are bound to yield positive results, in some cases they have little effect on investment decisions because, inter alia, of the relative magnitude of the exemption with respect to the amount of the investment. Moreover, their effects can be offset by those stemming from the application of the uniform tariff policy. Thus, while the agreement of tax incentives aims at encouraging the production of capital goods, intermediate products and consumer goods with a high content of Central American raw materials, the common import tariff tends primarily to promote the indiscriminate development of industries producing consumer goods, favouring imports of machinery, equipment and other inputs for agricultural and industrial production.

Notwithstanding the foregoing, important progress could be made in adapting the over-all economic policy instruments and bringing them into full operation. Thus, for example, advantage could be taken of the general tariff revision suggested earlier in this study to examine the industrial protection instruments that form part of it and to bring them into line with the law on tax incentives and other measures to promote industrial development.

This obviously would not suffice to achieve complete co-ordination between the tariff and tax exemption policies. Even if the import duties on capital goods, intermediate products and raw materials are raised, they would, in practice, have to be maintained at relatively low levels until there was a sufficient domestic supply capacity. In those circumstances,

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consideration might be given to the use of the preferential tariff system adopted in 1963, by virtue of which uniform protectionist duties would be established in advance, to enter into force once sufficient production capacity had been created.

The need for specific instruments arises from the fact that the general agreements are frequently inadequate as regards the establishment of certain strategic activities, or ensuring that they are set up under such conditions as would enable them to serve as the basis for new activities, whether in the manufacturing sector or in other branches of production without jeopardizing the return on investment. This is one of the most complex and difficult economic policy problems confronting the five countries today. Inasmuch as this is an entirely new stage of their development, the traditional instruments are incapable of dealing with it. The problem that arose in the past with respect to public orientation of the structure of production in the direction of export agriculture were relatively simple by comparison. The aim now is to stimulate the production of a wide range of products, through technically more complicated production processes, based on a far broader and more costly division of labour.

Under the circumstances, the Governments will have to adopt new policy instruments to guide the future structure of industry. Various types of measures might be used to that end. For example, a system of investment licences might be established, in conjunction with regulations governing the constitutional provisions on free trade. Under this system, which has had excellent results in certain Asian and Latin American countries, prior import permits could be instituted, and the mechanism set up under the Central American tariff protocol on dairy products could be extended to other products. However, before deciding to adopt measures of that kind, a careful study would have to be made of the problems that would arise from their inclusion in the operation of the economic system. But the first step required is to explore the possibilities of accomplishing, with the instruments at hand, the aim currently pursued.

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Everything seems to point to the fact that the Agreement on the Régime for Central American Integration Industries and the special tariff system would make for considerable progress in that direction. It would be necessary merely to overcome the stagnation which has tended to paralyze the application of the two instruments and improve them in several respects.

In the first place, it would be advisable to define the sphere of action of each by preparing separate lists of the industries that would fall under their respective jurisdiction. These lists would be strictly selective and based on the studies prepared by various institutions. Some of the procedures proposed by the Second Session of Directors of Planning Institutions could also be taken into account.

Secondly, the Régime for Central American Integration Industries should be brought into full operation and the principle established that the plants it is wished to set up in a specific branch of industry should be classified as integration industries once the first plant has been accepted under the terms of the Agreement. That would settle the long-standing problem as to whether the integration status relates to the plant or the industry, inasmuch as it would apply to both, although on a plant-by-plant basis. Thus, the Régime would be fully operative, and incidentally problems would be solved such as those recently emerging in relation to the establishment of a second plant for the production of tyres outside the sphere of the actual Régime.

Furthermore, it would be as well to emphasize the desirability of establishing regulations for this instrument in order to fix time limits for the study and processing of applications that would permit the submission of alternative projects and the selection of the project or projects that would be in the region's best interests. This would further give other Central American entrepreneurs - as well as external market suppliers who might be displaced - the chance to compete for the privileges of the Régime, subject to satisfactory compliance with the requisite guarantees, and might even facilitate the partial financing of certain basic industries with specific external funds that are not at present available for the purpose.

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In its turn, the special tariff system, by virtue of which customs duties are established beforehand for promotional purposes, would be vitiated if an attempt were made at this stage to incorporate other requirements - in addition to that of an installed capacity of at least 50 per cent of regional demand - so that the protection it affords may enter into force. In this respect, the intention would be, rather, to define its sphere of application. In actual practice, this system offers certain advantages which it would be as well to turn to account by using it in the case of intermediate products, raw materials and capital goods, in whose production the considerations concerning plant size and location are not decisive as under the Régime. In accordance with this criterion, the essential requisite for ensuring that the relevant production activities are established under economic conditions for Central America would be the availability of sufficient background data on the industry to establish an adequate level of protection that would not obstruct the attainment of other integration aims.

If consideration is also given to the protocols on assembly and on pharmaceutical industries that have yet to be prepared and signed, the whole would form a minimum group of requirements - sufficient in so far as the short term is concerned - for strengthening government instruments and setting a new pattern for the development of the manufacturing sector.

It would not be remiss to stress the acute shortage of technical personnel and the imperative need to increase and reinforce it. Only thus could industrial policy be properly implemented. This requires, in the first place, that the system of national industrial development institutes should be completed, by setting them up in countries where they do not already exist, while a distinction should be drawn between their function and those related to agricultural development and normal credit operations. Secondly, the development institutes' resources in respect of finance and, above all, technical personnel would have to be increased, and their links with the private sectors tightened. All this would enable them to fulfil their responsibilities better and to give effective co-operation to national public agencies in charge of other industrial policy questions; to provide advisory services to the private

/financing concerns

financing concerns now being established; and to take an active part in the development activities that the Central American integration bodies would be called upon to promote.

As regards activities at the regional level - in addition to the provisions that might be adopted by ICAITI, BCIE and SIECA - a small advisory group on the evaluation and preparation of specific industrial investment projects should be set up. It could, for example, form part of ICAITI and should be composed of high-level professional experts with considerable experience in the construction and management of manufacturing plants, i.e., specialists in textiles, chemicals, metal-transforming, etc. They could be recruited under external technical co-operation programmes, and could also help to promote Central American personnel training on the spot as the projects progressed. But their main work would be: (a) to advise integration bodies on promotional activities; (b) to provide advisory services to the national development institutes in the preparation of specific projects; and (c) to furnish the authorities responsible for managing the tax incentives with the relevant background data.

(e) Foreign investment in the industrial sector

The experience and data obtained have made it possible to define a Central American criterion regarding the foreign investment policy that should be adopted. This criterion postulates that external saving plays a complementary role with respect to domestic saving; that steps should be taken to ensure that external saving shall be an effective vehicle for absorbing up-to-date technology in the region; and that the characteristics and procedures of foreign investment policy should be in line with the requirements of industrial development policies, the allocation of resources and the protection of the balance of payments. Moreover, the progress made in economic integration has emphasized the need to make that policy regional

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in scope in order to make it really effective.<sup>2/</sup> Accordingly, there is no disagreement in Central America concerning the need for a common foreign investment policy and the aims it should pursue, nor is there ignorance of the means whereby it could be put into practice. By contrast, difficulties have arisen in reaching consensus regarding its operation and, specifically, the possible instruments to adopt and the relative rigidity or flexibility with which they should be applied.

A Central American agreement on foreign investment has been proposed, which would govern the policy of the five countries in this field. No decision has been reached in the matter, as it is considered that such an agreement might be detrimental to the investment promotion aims and, in particular, that it might make for rigid operation which would jeopardize the expetious approach to the many problems and circumstances that would have to be dealt with in practice.

For the same reasons, it has been impossible to reach agreement on the uniform application of specific measures in the area, e.g., the proposals regarding Central America's majority share in the capital of all new enterprises and the granting of the corresponding options to local investors; the limitation of BCIE's functions to the financing of Central American concerns; and the application to those enterprises alone of the law on tax incentives and of the privileges under the Régime for Integration Industries.

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2/ This criterion has been set out in detail, with special reference to foreign investment in industry, in the following documents: Centroamérica: lineamientos para una política de desarrollo regional (September 1964), by the Joint Central American Programming Mission; Bases para la formulación de una política regional en materia de fomento de inversiones (March 1965), by BCIE; and Nota de la Secretaría (sobre inversiones extranjeras) (June 1965), by SIECA. The statements of policy made in these documents were, in general, adopted by the First Session of Directors of Planning Bodies and by the First Session of Central American Ministers of Economic Affairs and Finance, and served as a basis for the official declaration which the Ministers of Economic Affairs formulated on the subject in June 1965. Since they included a large number of specific measures, this is not the place to go more deeply into the question.

The complex nature of the question suggests a gradual approach and the maximum of flexibility in forging the bases for a regional foreign investment policy, as more background data are accumulated and a careful study is made of the various problems. Although this would entail postponing the signing of a regional agreement, it would, at the same time, underline the need for legal provisions that could be introduced through successive government action.

The defining of the areas to which the Régime for Integration Industries would apply and of its management, as indicated above, would make it possible to tackle the question of foreign investment in the field of basic industries. Actually, this is one of the possibilities of the Agreement whose practical importance was realized only recently, when the serious drawbacks of establishing manufacturing plants for declared integration industries outside the Régime became apparent.

As regards established industries, the specialization and modernization agreements could include specific provisions governing the share of foreign investment in terms, for example, of joint projects with existing Central American enterprises. Lastly, as regards the extractive industries, it would be advisable to bring the laws on the exploitation of forest reserves and mineral deposits into full operation and to standardize them at the Central American level. By separating the problems into different fields of activity, a procedure of this kind would have the advantages of its own flexibility and of facilitating the application of measures for the solution of each particular problem.

Moreover, the effectiveness of the foreign investment policy established by the Governments would also be contingent upon internal requirements. In this respect, two such requirements have not been fully met: (a) the proper evaluation, from a technical standpoint, of specific foreign investment projects submitted to Governments, and (b) co-ordination of the action taken by technical, financing, fiscal and development institutions, at the country and regional level, with respect to such projects.

This is not the place to dwell on the first requirement, except to point out that one of the frequent problems facing the foreign investor in Central America is the shortage of institutions and specialized personnel to evaluate his proposals and bring them into line with economic policy, and the long process of negotiation to which his applications are subjected. As regards co-ordination, it would be essential, at least, to standardize the action of the national authorities responsible for applying tax incentives and industrial development measures - the Executive Council for tax questions, BCIE for financing, and SIECA and ICAITI for studies and technical decisions. Furthermore, these institutions, through the organization of technical groups, could adopt uniform criteria for evaluating foreign investment projects and establishing procedures for consultation and study, which would enable them to adopt decisions compatible with the principles of the regional integration and industrial development policies.

The above considerations relate to the proposal to channel direct foreign investment flows. Another equally important question is the expansion of those flows. In this respect, notwithstanding the moderate increment registered in the past two years, the situation in Central America reflects a scarcity, rather than an excessive flow of direct industrial investment from abroad.

If capital contributions are to be increased, it is particularly important to alter this state of affairs. This relates especially to the utilization of certain natural resources and to the establishment of specific export industries, such as, bauxite (alumina), nickel, pulp and paper, in view of the large investment they represent and, in some cases, of the need for technical processes and transport and distribution facilities which it would be difficult to obtain otherwise.

Accordingly, the foreign investment policy would have to operate selectively, indicating specific spheres of co-operation instead of establishing general norms favouring the indiscriminate inflow of foreign capital. This is an immediate result of the area's development strategy, which involves underlining the importance of certain activities or procedures and discouraging others which might have adverse or relatively unimportant economic repercussions.

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Although this might appear to lessen the possibilities of channelling saving from abroad, in actual practice the attraction for the foreign investor will depend upon the opportunities created by the common market, and upon the prospects deriving from the construction of a network of regional infrastructural works. Within these limits, the transfer of capital to Central America will be dependent upon the conditions prevailing in each economic sector, and upon the promotional efforts of the national and regional institutions. Apart from the general measures for the spread of information, this work should be steadily and vigorously directed at establishing contact with different private bodies and groups of foreign investors, with a view to their joint promotion of the projects of major importance to Central America.

To conclude, in so far as the defence of the Central American entrepreneur's interests is concerned, consideration should be given to the need to eliminate the inequality existing between his status and that of the foreign investor, whether in competing or forming a profitable partnership with him. Here again the imperative need arises to adopt the legislative measures alluded to above on monopoly and competition, in order to deal with such cases as absorption of Central American enterprises by foreign concerns. It would also appear desirable to encourage loan schemes and the provision of technical assistance, so that regional enterprises can strengthen their competitive position by specializing, improving their techniques and expanding their facilities, and by improving their distribution systems. As regards new industries, the necessary financing to make feasible the participation of regional private capital in adequate proportions would have to be obtained. Consideration should also be given to the use of public funds in setting up particular enterprises, on the basis of experience in several Latin American countries in the establishment of certain basic industries.

### 9. Agricultural policy

In relation to the economic integration process, agricultural problems have not been given the important place they deserve. Despite the slow growth rate of activities producing for the domestic market, and the deterioration in per capita consumption of certain staple articles of diet, basically the area has been able to maintain its self-sufficiency as regards supplies of agricultural commodities. Agriculture for export, on the other hand, has made considerable headway, spurred on by favourable world market prices and by successful efforts to introduce up-to-date techniques in its main lines of production.

In contrast to the situation in the manufacturing sector, there is little room for import substitution in agriculture, and many of the existing possibilities might be exploited even in the absence of multinational demand, since farming is not subject to the limitations deriving from production scales and market sizes which are characteristic of manufacturing industries.

Nevertheless, with the establishment of the common market, the significance of agricultural development for the integration process is steadily increasing. Although integration is largely a means of promoting industrial growth, it must not be forgotten that the development and technical progress of crop and stock farming constitute an essential requisite for the expansion of manufacturing activities.

What has occurred in other parts of Latin America serves as a useful pointer in this connexion; in countries where industry developed while agriculture remained stagnant, the latter has soon become a serious drag on the former's progress. On the one hand, external supplies of machinery, equipment and raw materials have been restricted by the inadequacy of the capacity to import and by the need to earmark more and more foreign exchange resources for purchases of food from abroad. On the other hand, the grown possibilities of demand for manufactured goods have been severely cramped by the minimal income levels of the rural population, and, in the case of urban groups, by the high proportion of family income that the buying of food has continued to absorb.

/In combination

In combination with other factors, these circumstances have not taken long to plunge the economies concerned back into a state of over-all stagnation, which in some cases is still persisting. A similar situation might arise in Central America if, alongside the rapid expansion of manufacturing activities, agricultural production for the domestic consumer market were to remain at a standstill, and if in the next few years exports of agricultural commodities did not succeed in sustaining the growth of the capacity to import.

(a) Specialization of production at the regional level

The mere existence of the common market changes the terms in which the problem of agricultural development presents itself in the Central American countries, and opens up better prospects for its solution.

In the first place, the common market will provide the conditions required to encourage a far-reaching process of zoning of production at the regional level, with the establishment of a closer relationship between the structure of production and the characteristics and potentialities of the available resources. Obviously, it is one thing to try to meet the whole of each country's requirements on the basis of its own resources, and quite another matter to satisfy them with the produce of a territory several times larger. This distinction becomes still more meaningful in the light of the need to expand existing output and, above all, to establish or strengthen many new lines of production in the future, in order to supply a demand that will be much more diversified than at present.

Secondly, greater possibilities for the zoning of production are afforded by the wide range of variations in climate, physical conditions, soil fertility and distribution of water resources in Central America as a whole, as well as by the marked extent to which one country differs from another in respect of the relations between the size of the rural population and the quantity and quality of the resources available for agricultural production. All this would enable the economic use of the less productive areas to be given a new structure, and would facilitate more intensive farming of the land best suited for various crops, which today is often technically and economically under-utilized.

/Since the

Since the distribution of natural resources for agriculture does not generally keep in line with political frontiers, the zones of specialization determined by the foregoing processes would probably extend to areas belonging to more than one of the Central American countries. To begin with, the bulk of the activities undertaken might centre upon the development of the central and western coastal areas of northern Honduras, as well as on the intensification and modernization of productive activities in the lowlands that stretch from north to south along the Pacific seaboard as far as southern Costa Rica. The development of the highlands of Guatemala, Honduras and Costa Rica, of the east coast of northern Honduras and of the Atlantic watershed of Nicaragua and Costa Rica might thus be envisaged as a long term task, although it ought to be started at once. This approach might be justified both by the nature of the problems connected with the intensive concentration of the population in specific centres and the necessity of remodelling time-honoured structures of production, and by the magnitude of regional investment requirements and the technical difficulties that would have to be overcome.

Advantage might well be taken of the favourable geographical position and the excellent production potential of the northern coast of Honduras to make it one of the zones producing new export items and an important source of agricultural supplies for the common market, when the Central American highway network is brought to completion. The Pacific lowlands are among those parts of Central America best provided with communications, and, in some countries, have always been the chief crop and stock farming areas. Accordingly, a good deal of effort should perhaps be directed towards the full incorporation of the less developed regions - such as parts of Guatemala and the south of Honduras - into market agriculture, and towards the stepping-up of production on the Nicaraguan coast.

Nevertheless, specialization by zones, rather than superseding specialization by countries, would represent a particular form of it, consisting in a gradual metamorphosis of the structure of agricultural production in each individual country. For example, pending the findings of more detailed studies, it may be supposed that El Salvador would continue to produce its traditional export commodities and to expand cultivation of

/high-value crops,

high value crops, but that it would probably become increasingly dependent upon the rest of Central America for its own supplies of staple articles of diet <sup>10/</sup> Nicaragua and Honduras, in their turn, might be expected to maintain and strengthen their position as leading suppliers of essential foodstuffs, while Guatemala could consolidate and expand its output of temperate-zone products - all this irrespective of what might be achieved in other agricultural activities, including those producing for outside Central America markets.

As regards livestock production, it seems likely that over the short term Costa Rica, Honduras and, above all, Nicaragua will continue to export the largest volumes, both within Central America and to countries outside the area. This would be the basis for the promotion of such activities in the future, but, in any event, the long-term problem would be much more complex. Prerequisites for dealing with it would be to clarify the lines on which meat and milk production would have to be developed, to establish complementarity patterns for crop and stock farming in respect of the cultivation of fodder crops and other inputs, and to predict the effects of such inter-relationships on the organization and location of the two sectors. From the outset, however, certain multinational integration procedures could be introduced, relating not only to inter-Central American trade in livestock product, but also to the development of complementary production zones situated in different countries - an undertaking that is already being attempted by Honduras and El Salvador - and the joint utilization of resources in short supply, of which a possible example might be the sharing of water resources between Costa Rica and Nicaragua.

These are merely preliminary comments on a subject that is still almost entirely virgin soil for research in depth. Moreover, the process under discussion is bound to be complex, whatever the geographical pattern it follows. A point to emphasize is that what is referred to here is the zoning of specialization, and that nothing has been said of degrees of

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<sup>10/</sup> El Salvador's share in total inter-Central American imports of agricultural commodities rose from 57 per cent in 1955 to 70 per cent in 1963.

diversification within each zone and at the level of the individual agricultural enterprise. The importance of these aspects of the question is obvious if it is borne in mind that in many parts of Central America the most serious problem is perhaps over-specialization - cultivation of a single crop - rather than under-specialization.

(b) Public investment in agriculture and improvement of production conditions

An agricultural specialization and reconstruction process of the type outlined above is an indispensable requisite if integrated economic development is to be facilitated. The latter's requirements could hardly be met on the basis of the possibilities afforded by the existing national systems of production.

The task of putting such a process into effect involves a strenuous effort in respect of public investment and the improvement of production techniques. Traditionally, the proportion of public investment allocated to agriculture has been relatively small, and has been mainly devoted to the development of transport facilities and communications for export activities. In these circumstances, the funds earmarked for promoting production for domestic consumption should be substantially increased, and the sector as a whole provided with an infrastructural network. Apart from the projects and services of a general character included in sectoral programmes at the regional level, special mention should be made of the construction of irrigation works and approach roads and the strengthening of agricultural programmes relating to training, extension services and experimental work.

The improvement of agricultural production techniques also entails substantial capital formation requirements, closely linked to the industrial development process. Firstly, there is the need to increase and extend application of the manufactured inputs characteristic of modern methods of farming. Accordingly, apart from the problems of how to encourage the spread of such practices, it is essential to ensure supplies of the inputs in question - for example, agricultural tools and implements, and chemical products such as fertilizers and pesticides - through the development of their production in Central America. Even if at first their prices were a

/little higher

little higher than those of the corresponding imported items, this disadvantage would be more than offset if the establishment of the industries concerned were based on the use of Central American resources and raw materials, and gave rise to an adequate supply system, independent of fluctuations in the capacity to import.

Hence the importance of seeing that industries producing agricultural inputs are installed on the soundest possible economic bases, and with due regard not only to isolated considerations of profitability, but also to their inter-relationships with the sectors and activities they supply. If at the same time research in the field of applied biology forges ahead, the increasing use of manufactured inputs will do much to improve the technical background of agricultural development in Central America.

The second requirement arising in this connexion - and one of those to which least attention has been paid up to now - lies in the development and modernization of marketing systems for agricultural and livestock products. This process necessitates investment in means of communication and transport media, as well as in storage and conservation facilities, processing industries and wholesale and retail markets. Apart from what has already been achieved in respect of highways and transport, during recent years the Central American countries have executed initial projects in this field, relating to the construction of dairy plants, industrial slaughterhouses, cold storage plants, silos and warehouses, fruit and vegetable canneries, and fish freezing units.

Investment in up-to-date plant is not enough to rationalize the marketing system, unless at the same time steps are taken to introduce radical reforms in the structure and interests of the middlemen's sector, so that the producer can be guaranteed a bigger share of the margin of profit and the consumer can be sure of reasonable prices. All this calls for the active participation of specialized public agencies that will study and promote physical and regulatory improvements in the traditional systems, take a share in ensuring supplies and controlling prices, and provide information and weights and measures services, as well as a standardized classification of products.

/The central

The central purpose of all these efforts is to regulate the geographical distribution of products, and, in the course of time, to improve their market status in respect of quality, and to reduce marketing costs. This would be a means of fulfilling one of the essential prerequisites for the above-mentioned zoning and diversification of the structure of production, and the introduction of more advanced techniques.

The history of export agriculture affords evidence that when well-organized markets are available and marketing margins are reasonable, while at the same time the support of the credit system and of technical assistance can be relied on, the Central American farmer is not slow to take advantage of the existing production opportunities. But when the organization in question is defective, and gives rise to wide margins of profit and inefficient and irregular distribution, with sharp seasonal fluctuations in prices and in the volumes of supplies reaching the market, little or nothing can be achieved by the development measures through which government institutions seek to encourage the farmer's spirit of enterprise.

(c) Regional aspects of development policy

The zoning of specialization in crop and stock farming, the expansion and improvement of agricultural infrastructure, and the introduction of more efficient production techniques, are objectives whose pursuit implies a radical change in Central America's agricultural policy. But this is one of the cases in which it is least possible to promote development by pushing up prices. In the first place, export market prospects are not particularly encouraging. Secondly, the prices of goods for home consumption are already high in relation to the income levels of the population, and it would be idle to think of raising them if the aim is to strengthen Central American demand for manufactured goods and lessen the tendency to costliness that characterizes domestic production in the early stages of any import substitution process.

The development of an efficient marketing system would tend to create certain production incentives on the side of agricultural income and prices, not through an over-all trend towards higher price levels but as a result of the stabilization of demand, the regulation of distribution, the reduction of marketing margins and the mitigation of the heavy losses at

/present incurred.



present incurred. But within these limits, the lowering of costs and the raising of productivity will depend directly upon the efficacy of government measures to increase credit resources and, concomitantly, expand technical assistance services and improve the supply of up-to-date inputs.

The key to agricultural development consists largely in the effective use of these three instruments, which, paradoxically enough, are perhaps the Achilles' heel of current agricultural policy. Except in one country, the organization of agricultural credit systems is in an embryo stage; technical services - including agricultural extension programmes - are scanty, and so is applied research; and production and supplies of seed and of chemical products are costly and limited. Furthermore, the relevant programmes are developed independently of one another, in accordance with the characteristically piecemeal nature of public action in spheres of interest to the agricultural sector.

To remedy this situation is an essential requisite both for the attainment of the objectives outlined and for the progress of economic integration in this field. The time has come for national systems to be developed on lines that will lead to their gradual integration through commodity trade, transfer of specific resources and investment effected with an eye to the interests of Central America as a whole, in conformity with the specialization pattern indicated above. This would entail minimum requirements in respect of co-ordination of agricultural policy at the regional level, and development of productive activities on a fully competitive footing.

Some progress has been made in this direction by virtue of the studies that have been carried out with the help of FAO and other agencies. Furthermore, initial contacts between Central American technical experts and executives were established at the meetings of the Agricultural Development Sub-Committee and the Ministers of Agriculture that were held in 1964, and forward steps have also been taken through the work of the Co-ordinating Committee on Marketing and Price Stabilization in Central America.

/Despite the

Despite the handicaps deriving from the deficiencies of the existing systems, the common market has made it possible to achieve significant increases in output of various agricultural commodities, and has encouraged investment in allied industries.

Thus, in 1963 inter-Central American trade in agricultural commodities exceeded 22 million dollars, its rate of expansion having almost trebled since 1955, irrespective of trade in processed products of agricultural origin, which is by no means negligible.

With respect to the undertakings outlined in the preceding paragraphs, especially those connected with the improvement of production techniques, the advantages offered by integration, generally speaking, derive from the possibility of making more efficient use of the area's limited resources. This includes the establishment of regional financing systems in combination with those existing at the national level, as well as the exchange and co-ordination of technical cadres, brought into service under specific multinationally concerted programmes. Efforts can also be pooled in the following fields: agricultural education and training of specialized personnel; co-ordination and guidance of agricultural research and experimental work on a regional basis, as regards the demarcation of fields of study and the division of labour; and execution of plant and animal sanitation projects.

In this way considerable savings might be achieved and the efficacy of public action in the fields in question could be substantially improved. Accordingly, specialization in higher education for agriculture has been discussed by the Higher Council of Central American Universities and the Ministries of Agriculture have promoted initial efforts to co-ordinate basic research work, with the support of the Inter-American Institute of Agricultural Sciences.

(d) Full operation of the common market for agricultural commodities

The problems to be dealt with are so vast, and resources so limited, that a strict order of priorities must be established for activities that will have to be embarked upon at once. One of the most urgent tasks is that relating to full liberalization of trade and tariff equalization in respect of crop and livestock products, as an indispensable requisite for

/the subsequent

the subsequent development and rationalization of production. The various aspects of this question were analysed in a study jointly presented by the ECLA secretariat and FAO at the first session of the Agricultural Development Sub-Committee, held in 1964.<sup>11/</sup> On the basis of this report, the Sub-Committee formulated and submitted to the Executive Council of the General Treaty on Central American Economic Integration several recommendations whose adoption would mean that the existing restrictions on trade in some of the commodities subject to special régimes could be abolished.

In any case, these régimes are relatively few in number, and many will have automatically disappeared by the time the interim period comes to an end in 1966. Thenceforward, measures to deal with payment and flow in intra-area trade in agricultural commodities will necessarily be mainly confined to the restrictions currently affecting traditional export items - time limits for whose elimination have not been established - and to regional co-ordination of price and supply control policies in the case of basic gran products. Such problems are outside the province of free-trade policy, and their solution depends upon the application of measures relating to external trade and to credit and production policy.

Before trade in traditional export commodities could be completely liberalized, it would be necessary to adopt co-ordinated measures to regulate production in accordance with the limited possibilities of the world market, to promote joint programmes for the replacement of such commodities by substitutes in certain areas, and to bring national credit policies into harmony. Thus, the establishment of free trade in the commodities in question is not a product of the immediate need to increase intra-area trade flows, but a requisite for the formulation of a common trade policy vis-a-vis third countries and for concerted action in the negotiation of international commodity agreements, as well as for taking

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<sup>11/</sup> See The Central American common market for agricultural commodities (E/CN.12/CCE/SC.6/4; FAO/CAIS/64/6), subsequently reproduced under the same title in the Economic Bulletin for Latin America, Vol. X, No. 1 (March 1965).

the first steps towards the constitution of a Central American customs union when the times comes to eliminate customs formalities on the frontiers of the five countries concerned.

Unquestionably, however, the most important problem lies in the regularization of trade in basic commodities for domestic consumption. Lack of co-ordination among national price and supply control policies might vitiate the benefits of free trade and tariff equalization, by hampering the development of such lines of production, their geographical redistribution and their technical progress. Thanks to the studies which have been carried out during several years past, it has been possible to define the fields in which co-ordination efforts should be concentrated, namely: (a) joint determination of minimum or support prices, on the basis of a standard product classification system and the structure of transport costs in Central America, and within reasonable limits as regards their relation to the prices of imported goods; (b) construction of a Central American network of storage facilities; (c) internal and external financing of the facilities in question, and subsequently of the purchasing programmes put into effect by national government agencies; and (d) joint control of imports and exports of the commodities concerned.

The Co-ordinating Committee on Marketing and Price Stabilization has made initial experiments in connexion with the joint establishment of minimum prices. Headway has also been made in the implementation of the silo-building programme, and the special protocol to regulate trade flows, co-ordinate supply policy and ensure the fullest possible freedom of trade for which the General Treaty provided was signed at the first meeting of Ministers for Economic Affairs and for Agriculture, held in 1965. The main provisions of the instrument in question are designed to give legal status to the Co-ordinating Committee, define its functions, and regulate foreign trade in basic foodstuffs.

The difficulty of reaching agreement on the terms of this protocol stemmed partly from the lack of unanimity as to the proper scope of public action in this field, and partly also from the divergent positions of countries importing and exporting the products covered by the draft. However, these were minor differences in relation to the whole set of

/arrangements concerted;

arrangements concerted; they were soon settled, and the five countries agreed upon the export and import controls that are essential for the success of Central America's price and supply regulation policy in its entirety.

Furthermore, as part of marketing and development policy, consideration should be given to the establishment of a reserve of basic foodstuffs, set up and managed at the regional level, with the help of international supply programmes extrinsic to normal market operations. The following might be the advantages deriving from an arrangement of this type: (a) co-ordination and management of national programmes, particularly in times of scarcity, would be facilitated; (b) it would be easier to regulate foreign trade in the products concerned; (c) price fluctuations would be somewhat mitigated; and (d) pressures on the balance of payments during periods of food shortage would be relieved.

Lastly, it should be noted that the effective application of the protocol referred to would necessitate detailed regulations concerning the procedures for fixing support prices to benefit the producer, as well as purchase and storage operations, and protection for the consumer. It would be equally or even more important to improve the organization and operation of national price stabilization institutions. In several cases, marked deficiencies in respect of technical and executive personnel are observable, and in other, the execution of purchasing programmes, and, therefore, their effects on market prices, are cramped for want of funds.

(e) Agricultural development in relation to the common market

At the present time, activities under the integration programme in the agricultural sector are concentrated on bringing the common market into full operation, and nothing has as yet been done to promote development, except for certain advances made in co-ordinating research work and providing specialized agricultural education.

The formulation of programmes of regional scope might constitute a valuable means of stepping up directly promotional activities. It would enable the available technical and financial resources to be reorganized and more efficiently utilized in pursuit of practical and realistic objectives.

/The information

The information and background data contained in the studies prepared by FAO and the ECLA secretariat, and in those recently carried out by the Joint Central American Programming Mission, afford useful pointers to the directions that such activities should take. If in addition the experiments and undertakings currently in progress in some of the Central American countries are taken into consideration, it might be suggested that in the immediate future effort should be concentrated on the formulation and execution of three regional programmes: (a) diversification of agricultural export lines; (b) expansion and modernization of activities producing basic cereals to cover Central America's requirements; and (c) development of production of meat for export and of milk products to supply the common market.

Although trade policy questions will be discussed in the next section, reference may be made here to the measures affecting the development of production which would be included in programmes essentially concerned with trade. In recent years, the possibility has arisen of diversifying agricultural exports through the production of tobacco and specific fruits and vegetables for the United States market. Relevant studies have already been embarked upon, but if decisive impetus is to be given to the exploitation of these opportunities, certain important requisites will have to be fulfilled. In the first place, more intensive research work will have to be undertaken to indentify the areas best suited for the cultivation and acclimatization of different varieties. Secondly, far-reaching extension services and technical training programmes will need to be organized and, in the field of investment, storage and conservation facilities will have to be constructed and efficient transport links with consumer centres established. Another possibility worth exploring is that of combining programmes of this kind with others aimed at diversifying production in specific areas or at replacing traditional export products by substitutes in parts of the region unsuited for their cultivation.

As regards the promotion of crop farming for the home market, commercial production of maize, beans, rice and sorghum should be developed; the zoning of specialization should be aimed at;; and, in some instances, the geographical distribution of crops should be altered - all this within the

/framework of

framework of a co-ordinated support price policy. Substantial requirements would thus be entailed in respect of financing, supplies of inputs, and technical assistance with a view to increasing yields and reducing production costs.<sup>12/</sup>

The improvements effected in transport and communications, as well as the installation of the first up-to-date slaughterhouses and milk pasteurization and processing plants, have contributed to the development of livestock production in some of the Central American countries. Furthermore, direct measures have been adopted to increase output and improve herds. But there is still a manifest lack of elasticity on the supply side which is a serious hindrance to the expansion of exports and the satisfaction of domestic market demand. In these circumstances, herd-restocking programmes need to be intensified, and the cultivation of artificial pastures and fodder crops should be improved and based on more advanced techniques, with due regard to the fact that sales to foreign markets will largely depend upon the competitive position of supplies from Central America.

Estimates of the milk supply suggest that Central America has attained a high degree of self sufficiency in this respect. Even so, imports of milk products amount to several million dollars every years, largely because local supplies are not turned to account for want of communications or owing to deficiencies in the marketing or processing systems. Tariff protection and import quota provisions reserve practically the whole of the Central American market for the area's own production, and constitute a powerful instrument for the development of dairy farming. Yet Nicaragua is the only one of the five countries in which any considerable effort to take advantage of these opportunities is being made so far.

If a regional approach to the organization and execution of these programmes is to be adopted, a necessary step will be to overcome the handicaps deriving from Central America's limited experience in respect of agricultural

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<sup>12/</sup> To start with, advantage could be taken of hybrids and improved strains developed in similar areas in other countries, until Central American research programmes begin to yield results. The Joint Programming Mission will shortly be completing a study on the nature and scope of a programme of this type.

development and from the lack of resources affecting most of the national institutions responsible for such activities. In any event, action at the Central American level should be channelled towards co-ordination of credit facilities, provision of highly productive inputs, technical assistance and market organization. To this end, attention might first be focused on the organization of working groups, composed of technical experts from government departments, integration institutions and foreign technical assistance agencies, to make a start on the study and formulation of the initial programmes. Advantage could thus be taken of experience gathered in other fields, as was done in the case of the Central American highway plan, when a similar type of co-ordination machinery was adopted in preparing the relevant projects. Financing requirements could then be covered by means of joint action on the part of the Central American Bank, development institutes and national credit systems. Lastly, although the executional phase would obviously be in the hands of the national authorities, it might be based on specific inter-country co-operation patterns in both technical and financial respects. For example, groups of Central American technical experts might perhaps undertake particular aspects of the work of supervision, and another possibility would be to establish joint multinational investment and discounting systems, especially in the case of programmes relating to supplies for the Central American markets.

These remarks can hardly be brought to a close without some reference to two general problems, one bearing on the economic use of capital and selection of techniques, and the other on the participation of Central America's rural population in the development of the area.

As regards the first of these problems, programmes should be deliberately designed to encourage capital saving and expansion of employment, with due regard to the acute shortage of investment funds and the needs of other sectors, as well as to employment problems. This means that the mechanization process should be carried out on highly selective lines, being confined as far as possible to export activities, and even in their case to certain operations of key importance. The work of introducing more up-to-date agricultural techniques should be concentrated rather on the production of inputs - improved strains, fertilizers and pesticides - and on the execution

/of projects



of projects entailing labour-intensive techniques, such as those relating to soil conservation, the building of approach roads and the construction of irrigation works.

With respect to the second problem, the prevailing land tenure systems and the low level of skills prevailing in the rural labour force will make it difficult for large groups of the agricultural population to participate in the foregoing programmes, at least in the immediate future. Nevertheless, in drawing up the programmes in question and designing the instruments of action and the measures of economic policy on which they are to be based, every possible endeavour should be made to incorporate the rural labour force into commercial production. It should be noted that the attainment of this objective largely depends upon the strategy adopted, and particularly on procedures relating to credit facilities, agricultural extension services and the development of co-operatives.

Unless this approach is adopted, the social problem of the rural sector will remain unsolved, and subsistence farming will continue to hamper economic development. In such circumstances, production might perhaps be expanded and pressures on the balance of payments relieved, but it would be impossible to fulfil the aim of encouraging industrial development by strengthening the purchasing power of the rural population and thus enlarging the domestic market for manufactured goods.

#### 10. Trade policy

##### (a) Towards a trade policy for development

The purpose of the integration movement is not to place Central America in a position of self-sufficiency and economic isolation. On the contrary, considerations relating to the efficiency of systems of production, as well as the very characteristics of the common market itself, make this latter the most appropriate instruments for keeping the Central American countries open to international trade flows, without detriment to the steady improvement of their income levels.

/Two major

Two major factors determine significant differences between trade policy as traditionally pursued and as it should be applied nowadays. The first of these is the need to make it an instrument of deliberately planned action to promote the development of the five economies; the second is the change in international economic relations and the more exact information available as to their repercussions on the development and structure of the Central American countries.

Trade policy had little to do with the development of the agricultural export economy, which, as far as external factors were concerned, was based to a much greater extent on investment and financing from abroad. In this way the banana producing and distributing enterprises and the coffee exporting companies were established, and foreign firms and banks facilitated the construction of processing plants and advanced production and export credits. In accordance with the theory and practice of the time, trade policy confined itself to encouraging and facilitating exports as much as possible, through low duties, shipping agreements, most-favoured-nation treatment, and trade treaties with the industrialized countries.

The collapse of multilateralism, the exhaustion of the dynamic impetus initially afforded by export markets, and the tendency for multinational economic groupings to be formed, have radically altered the mechanics of international trade relations. The result has been the formulation of longer-term trade policy objectives, which in Central America's case might be defined in the following terms: (a) stabilization of prices and maintenance of maximum volumes of traditional exports; (b) adjustment of total imports to export earnings and returns on long-term foreign capital, and modification of their composition with a view to fostering the growth of internal economic activity; and (c) promotion of the development of other lines of production and the opening-up of new export markets, in order to give fresh dynamic impetus to the external sector, develop natural resources and facilitate the diversification of the structure of production.

/The radius

The radius of action of trade policy is thus broadened, particularly in so far as elements of autonomy are introduced into monetary, balance-of-payments and financing policies, and those previously latent in tariff policy become more markedly operative. At the same time, the inadequacy of the customary approaches and instruments for the purpose of attaining the new trade policy objectives has grown conspicuously apparent.

In this connexion, it is worth while to draw a few distinctions which are of use from an analytical standpoint. The combined operation of specific tariff and monetary policies might serve as a means of bringing the level and composition of external purchases into line with the capacity to import, and thus fulfilling one of the aims which their application traditionally pursues.

But the deficiency of the policies in question lies, as regard monetary matters, in their disregard of considerations relating to the growth of income and the maintenance of the levels of internal activity. Moreover, some of the contractual instruments - such as the most-favoured-nation clause and tariff preference agreements - do not suffice to secure the direct end they serve, i.e., the efficacious promotion of exports.

The foregoing conclusions calls for a more detailed explanation, with reference both to traditional exports and to new lines of production for international markets. In the case of the former, the internal taxes and controls imposed by the importer countries, their economic links with countries that compete with Central America, and the policy of subsidizing certain producers, weaken or wipe out the favourable effects of the most-favoured-nation clause or to tariff preferences. What is more, the persistent trend towards an imbalance between international supply and demand, by which many of the exports under discussion are affected, makes the application of these general instruments still less operative, and underlines the necessity of applying instruments of another sort, such as agreements on price stabilization and regulation of supply in respect of specific products.

/A similar

A similar situation arises in connexion with new export lines. The reasons are to be found in the very limited supply the area has to offer, in the Central American countries' disadvantageous competitive position vis-à-vis others at relatively more advanced stages of development, and in the miscellaneous factors hindering their access to external markets. Here it seems obvious that the efficacy of trade policy depends upon the application of measures which must be complemented with instruments of another kind, such as the financing of new investment; the establishment of quotas to guarantee a regular volume of exports; technical co-operation with a view to improving the quality of the goods produced and satisfying the requirements of international markets; and special marketing arrangements.

Thus, until a change takes place in the world economic order, Central America's best plan is to apply as many different specific instruments as possible, within the framework of over-all measures, to consolidate and expand trade flows with the rest of the world. In the meantime, it is to be hoped that the Central American countries will continue to co-operate in the efforts of the United Nations Conference on Trade and Development to seek more effective and equitable world trade patterns; will go on collaborating with the rest of Latin America in the task of promoting economic integration at the level of the whole region; and, in conjunction with the other developing countries, will be able to take their part in the process of solving the problem of international liquidity, upon which multinational monetary institutions are now embarking.

(b) Trade policy and economic integration

The trade policy measures adopted by the Central American Governments at the regional level have hitherto pursued two major objectives: (i) that of channelling imports on jointly concerted lines in accordance with the area's development requirements; and (ii) that of preserving the internal unity of the common market. The former aim was fulfilled by the unification of national tariffs in the common import tariff, and is safeguarded by the Contracting Parties' commitment, assumed in the Central American Agreement on the Equalization of Import Duties and Charges (article VII),

/ "to refrain

"to refrain from signing new agreements or tariff concessions with other countries which are contrary to the spirit and objectives of the present Agreement". More recently, when the Standard Central American Customs Code was signed, customs formalities, procedures and operations were unified, and the principle was laid down that no member country should grant third parties more liberal concessions than were therein agreed upon. It was also stipulated that agreements of this type, as well as the establishment of free zones and free ports in the common market territory, should be concluded or decided upon by the five countries in conjunction.

The second objective gave rise to an undertaking not to sign unilaterally with non-Central American countries any treaties or agreements which are contrary to the principles, spirit and purposes of economic integration.<sup>13/</sup> Moreover, in agreements which, subject to this restriction, Governments conclude unilaterally with third parties, on the basis of most-favoured-nation treatment, the "Central American exception clause" is maintained, and inter-Central American consultations with a view to the adoption of a common united position must be held before any member can accede to commodity or trade agreements, or join new international economic agencies.

As regards monetary questions, the treaties contain the following provisions: (i) the Central Banks of the Contracting States shall co-operate closely with a view to preventing any currency speculation that might affect the rates of exchange and maintaining the convertibility of national currencies on a basis which will guarantee freedom, uniformity and stability of exchange; (ii) any Signatory State which established quantitative restrictions on international monetary transfers shall adopt whatever measures are necessary to ensure that such restrictions do not discriminate against the other Central American States; and (iii) should serious balance-of-payments difficulties arise, the Executive Council and the

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<sup>13/</sup> This commitment is incorporated in the Multilateral Treaty on Free Trade and Central American Economic Integration, article XXIV, and in the General Treaty on Central American Economic Integration, article XXV.

Central Banks shall recommend to the Governments of Signatory States solutions compatible with the maintenance of the multilateral free-trade régime.<sup>14/</sup>

In these circumstances, it may be asked how far the present scope and jurisdiction of trade policy pursued unilaterally by member States extends. A strict interpretation of the legal provisions cited would lead to the conclusion that its radius of action is now reduced to the conclusion of most-favoured-nation agreements with third countries, subject to the limitations implicit in the Central American exception clause. This is in fact the general rule in the case of trade agreements which have remained in force since the General Treaty came into operation, or which have been concluded since then by various states members with countries outside Central America.

It might be argued that certain trade agreements signed individually by a member country would be fully valid in so far as they did not contravene the undertakings contracted vis-à-vis the common market and were not explicitly debarred by the provisions of the integration treaties. Cases in point would be barter agreements or tie-in arrangements, against tariff preferences or finance lines granted by third countries.

Apart from the fact that barter and import quota agreements would be subject to consultation with the other members of the common market, as stipulated in the Multilateral Treaty (article XXIV), their compatibility with "the principles, spirit and purposes" of the integration movement would in any event be open to question. It is easy to imagine cases in which the conclusion of such agreements might have unfavourable effects on inter-Central American trade. For example, in specific circumstances, barter and tie-in arrangements might restrict the market available for Central America's own production. This problem would not arise in the immediate future, since production on a regional basis is not yet developed, but the possibilities of establishing certain productive activities might be reduced.

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<sup>14/</sup> See the Multilateral Treaty on Free Trade and Central American Economic Integration, article VIII, and the General Treaty on Central American Economic Integration, article X.

In the case of exports, it is again true that the agreements under discussion would not affect the formal unity of the common market. But, in default of a full customs union, the differing degrees of importance attached by the countries concerned to the promotion of their external sales on the one hand, and to import substitution policy and inward-directed development on the other, might militate against economic integration. In the first place, disparities between the balance-of-payments positions of the Central American countries might be created or intensified, and the problems relating to balanced development might be aggravated. Secondly, certain agreements concerning foreign investment might also be incompatible with integration, inasmuch as they would unilaterally grant third countries access to the benefits of the common market.

Although the situations described are not particularly serious at the present time, they might some day acquire very different proportions. What is really important, however, is not so much to take advantage of the scanty room for manoeuvre open to trade policy at the level of each individual country, as to make use of the ample opportunities afforded by a policy of Central American scope.

Joint action of the part of the five countries would enable them to offer other countries a more attractive market than any single one of them could, and would therefore strengthen their bargaining position. In this connexion, it is worth while to note that the separate conclusion of agreements based on the most-favoured-nation clause would exert an adverse influence by dissipating or undermining the area's bargaining power, and placing difficulties in the way of regional action. In the near future, therefore, it would be as well to adopt a provision similar to the so-called "European clause" - established in 1960 by the Council of Ministers of EEC - by means of an appropriate addition to the Central American exception clause. The "European clause" stipulates that when commitments under the Treaty constituting the Community and the provisions of the said Treaty concerning the progressive establishment of a common trade policy so warrant, new negotiations shall be conducted,

/within the

within the shortest possible period of time, to introduce all such amendments as may be necessary in agreements concluded by individual members with third countries.

Furthermore, the formulation and adoption of a common trade policy would restore the possibility - at the regional level this time - of turning the tariff to account for negotiation purposes, and, in general, would greatly widen the range of trade policy instruments. At the same time, it would facilitate co-ordination with other policies, such as those relating to industrial expansion and to the inter-country balance of development. In the first place, the installation of certain industries which, although of basic importance for the growth of the area's manufacturing sector, could not be sustained by the common market alone, would be rendered economically viable. This would also apply to various industrial projects - some of them now in course of preparation - which would be likely to lead to undesirable duplication of investment if they were envisaged merely within the bounds of the common market. Secondly, a common trade policy, by increasing and diversifying available production opportunities, would facilitate the adoption of measures to promote balanced development, in face of circumstances in which the expansion of the export trade of any country whose difficulties in this respect are particularly serious is an essential requisite for the elimination of the existing disequilibria.

(c) Scope and characteristics of a common trade policy

The task of formulating and executing a common trade policy is by no means the same in Central America's case as in that of the European Economic Community, for example. In the latter, complex and highly developed national policies have to be brought into harmony, whereas in Central America the task in hand consists in filling a gap, in establishing and co-ordinating at the regional level a line of action which has made relatively little progress in the individual countries. In this sense, it might be supposed that the work is simplified, but the very lack of experience in the field of trade policy, and the under-diversification and small size of the export sector, create problems that are difficult to solve.

/The problems



The problem in question largely derive from the necessity of bringing into line and co-ordinating with one another trade policy objectives and other Central American policies and instruments of action. It has already been pointed out, in the context of industrial policy, that the common import tariff needs certain adjustment in order to increase its efficacy for the purposes of concluding trade agreements with third countries.

Several measures which might be included in such agreements - for example, tariff preferences granted to third countries - might also be counteracted by the operation of balance-of-payments policy, if, for example, exchange or credit restrictions on imports were established. Consequently, in the process of co-ordinating monetary and balance-of-payments policy upon which the Central American Monetary Council has embarked, in compliance with article X of the General Treaty, specific provisions should be introduced with a view to ensuring that the policies in question are at all times compatible with trade policy.

One of the problems that might perhaps arise, as the Central American customs union has not yet been brought into full operation, is that the attractiveness of the common market might be somewhat diminished by the fact that imported goods cannot at present circulate freely among the member countries. Despite the resultant difficulty of reorganizing distribution systems on more efficient lines, the problem does not seem likely to be of major importance in practice, should it present itself. In the first place, the reorganization of distribution might be facilitated by the improvement of the provisions relating to transport and customs formalities for goods in transit. Secondly, the drawback in question would be fully offset by the benefits of uniform treatment in the five countries for goods imported under the aegis of whatever preferential régimes are agreed upon in future Central American trade treaties.

Nevertheless - particularly in view of the advantages of fragmentary experiments from the standpoint of paving the way for a full customs union - consideration should be given in the formulation of such treaties to the possibility of liberalizing trade in some of the goods imported from the non-Central American countries with which the agreements were concluded.

/There would

There would be no serious grounds for objection to such measures, when applied in relation to products whose origin was easy to identify and whose fiscal importance was slight.

Apart from the difficulties of satisfactorily overcoming the obstacles indicated, the main problems that would have to be faced in the early stages of formulating a common trade policy relate to the temporary co-existence of different development patterns, as mentioned in Part I of the present study. They also derive from the absence of non-traditional activities which could serve as the pivot for an immediate effort on Central America's part to develop its exports to the rest of the world.

As regards the accession of Central American countries to international agreements concerning trade in traditional exports, experience shows that individual or national interests have over-ridden the principle of joining forces. The divergencies that have arisen are more apparent than real, since it is extremely unlikely that from the national standpoint piecemeal action can prove more efficacious than the combined efforts of the five countries.

What is often overlooked is that the establishment of common ground or the unification of the positions adopted by Governments with the interests of private enterprise, involves permanent and systematic action, very different in nature from the informal agreements that may be reached shortly before an international meeting is held. For example, preparatory work should be undertaken with a view to the standardization and reform of internal credit and development policy, as well as the adjustment of production to external market capacity, through distribution patterns and compensation possibilities based on the development of new export lines.

Although a start should be made on this work without delay, it obviously cannot be expected to bear fruit over the short term. But merely to call attention to it sheds some light on the closeness of the links that should be established between trade policy and development policy in other specific fields. In the same way, the analysis of questions relating to traditional exports suggests that the possibility of building up a Central American trade policy depends upon whether a regional approach is also adopted in the implementation of agricultural policy programmes.

/Otherwise, unco-ordinated

Otherwise, unco-ordinated development of the structure of production for export might make it difficult for uniform positions to be taken vis-à-vis third countries. This is happening at present in respect of Japan, with whom, in consequence of the pattern followed by the development of the cotton sector, some countries - Nicaragua, for example - pile up large surpluses on the corresponding trade balance, whereas others, such as Costa Rica, register equally big deficits. If the complete economic integration of Central America were an accomplished fact, situations of this kind would not arise, because the determining factor would be the area's aggregate balance instead of each individual country's net results. The same end might be served, even at the present time, by a common trade policy, but it is precisely the existence of the deficits in question that makes it more difficult to dovetail the interests of the five countries for this purpose.

As regards new export lines, trade policy measures should be supplemented by a strenuous endeavour to expand the area's production capacity. Its present low level is a considerable handicap, for even if all problems of access to international markets were solved, the Central American countries would find it difficult to channel substantial new trade flows over the short or medium term, except in the case of a limited number of products.

All the activities described should be defined in terms of specific programmes, related to particular products, and based on the types of instruments and measures mentioned above. In this context, quite apart from their intrinsic value, the studies that are being carried out in connexion with a possible economic association between Central America and Panama, as well as those shortly to be undertaken with respect to the prospects of developing trade relations between Mexico and the common market, will make extremely useful contributions to the process of shaping a Central American trade policy and establishing its different patterns and procedures.

This approach is advisable, not only because of the relative inefficacy of over-all measures to which allusion has already been made, but also on account of the general and marked inadequacy of existing production to

/supply new

supply new and broader external markets. On such a basis, it would be easier to settle questions relating to the ways in which the benefits thus accruing to Central America should be distributed among the member countries. Such questions would call for specific measures - at least until the economic integration movement led to the adoption of instruments of wider regional scope - in the fields of taxation and investment financing, which would enable the problem of balanced development to be effectively dealt with from an over-all standpoint, irrespectively of what might be happening at a given moment in particular sectors.

Nevertheless, there are some general matters which are already claiming attention, and which a Central American trade policy could not by-pass. One of the most important of these is the movement to establish the Latin American common market. There can be no possible doubt as to its desirability or as to the necessity of taking part in the task of laying its foundations. The trouble is that hitherto no attempt has been made to explore the various alternative ways of linking up the Central American movement with ALALC.

In this connexion, one possibility of noteworthy and immediate significance for the Central American countries is to be found in the Latin American industrial complementarity agreements for which provision was made in the Montevideo Treaty and regulations have been established in subsequent ALALC resolutions, and to which a more recent contribution is being made by the technical and economic studies in depth that IDB, the ECLA secretariat and the Latin American Institute for Economic and Social Planning are helping to carry out. Such agreements might assist in solving several of the industrialization problems that loom largest in the Central American countries, by broadening the base of their market and facilitating the investment and technical training processes, under a plan both rational in its technical and economic characteristics and equitable as regards questions of location and distribution. Central America should take its full share in such activities from the very outset, and, in addition, should advocate that complementarity agreements be left open to the accession of any interested Latin American country, whether it is or is not a member of ALALC or of the Central American common market.

/Furthermore, it

Furthermore, it would be very useful if, instead of waiting upon events, the Central American countries were to play an active part in the study and negotiation of more satisfactory over-all instruments. They could thus make effective endeavours to ensure that such instruments were really in line with their requirements and with those of the relatively less developed countries in general, and could also offer a direct contribution in the shape of their own integration experience, some aspects of which might serve to elucidate problems and possibilities at the Latin American level. A suitable framework for all these undertakings might be afforded not only by direct contacts between the Central American market and ALAIC, but also by the studies and meetings which ECLA is arranging in compliance with the resolutions recently adopted by the Governments members of the Commission, at its eleventh session.

(d) Organizational patterns and procedures

A Central American trade policy unquestionably calls for specific organizational patterns, enabling joint action on the part of the five countries to be outlined and put into effect. A few steps have already been successfully taken in this direction, through the concerting of a common and co-ordinated position in various international economic agencies and conferences, such as the United Nations Conference on Trade and Development, IA-ECOSOC and ECLA. Similarly, arrangements have been made in Brussels for the Central American common market to be represented before the European Economic Community, and more frequent contacts with ALAIC are beginning to be established through the secretariats concerned. Again, at the First Meeting of Central American Ministers for Economic Affairs and Finance, various resolutions were adopted in this connexion, notably recommendations to set up national foreign trade commissions and co-ordinate their action, and to establish a SIECA unit specializing in this field; the latter has already been constituted. It would be advisable for technical assistance resources to be made available and training activities to be organized, both in the individual countries and at the regional level, in order to ensure more efficacious implementation of these recommendations.

/Although the

Although the foregoing measures would serve to promote various activities relating to the formulation of a Central American trade policy, they would not be enough, especially where its scope and execution were concerned. A regional negotiatory body would be needed, through which the five countries could take joint action in concluding economic agreements with other States. At the meeting of Ministers for Economic Affairs and Finance, it was proposed that a Central American Foreign Trade Commission, composed of representatives of each of the States members of the common market, should be set up in this capacity, but decision was withheld until additional background material could be prepared.

More careful study of this question brings to light several of the drawbacks that would attach to the constitution of such a body. To begin with, the project would be open to the usual objections to the establishment of new institutions. But the most serious difficulty is that it might lead to the dispersion of functions which seem more appropriate to the Economic Council and the Executive Council of the General Treaty. Since tariff policy is so closely linked to trade policy, and since the latter is an instrument of decisive importance for the promotion of development as part of an integration process, it is not clear how the two Councils could properly discharge the duties laid upon them under the Treaties, if their faculties did not include that of channelling trade relations with the rest of the world. To reinforce the efforts of these integration organs in the field in question, steps should be taken to secure the systematic collaboration of the Ministries of Foreign Affairs, the Monetary Council and the Central American Bank, within their respective spheres of jurisdiction. It might even be desirable - in connexion with the reorganization of the agencies of the General Treaty that is suggested at the end of the present report - for a specialized committee to be set up to deal with matters of trade policy. There would then be no dispersal of functions, and the order of proceedings could be as follows: (a) the Economic Council would lay down general and specific guidelines for the policy to be pursued; (b) the Executive Council would conduct negotiations; (c) treaties with third countries would be approved and signed at joint meetings of the Ministers for Economic Affairs and for Foreign Affairs.

/This would

This would entail certain amendments of the Central American legislation. Although the provisions of the various treaties in force are adequate to maintain the formal unity of the common market, they are at once too general and too limited to serve as the basis for a really far-reaching regional trade policy. Here again, as in other aspects of the integration process, it would be wise to progress by gradual degrees, and to widen the radius of multinational action on the basis of tentative experiments.

In this connexion, it would be advisable for the Economic Council to establish regulations concerning the application of article XXVI of the General Treaty and article XXIV of the Multilateral Treaty, which would specify, in relation both to the inter-country consultations therein envisaged and to joint action on the part of the Central American countries vis-à-vis particular agreements and situations, the cases in which they would be in order, and the procedures to be followed.

Thus, in an initial phase, government policy could be channelled with a view to the preparation of the necessary studies, the predetermination of a concerted regional position, and the conduct of joint negotiations with other countries for the conclusion of the first trade treaties.

In the capacity of a common delegation - as agreed upon in the case of the preparatory work for economic association with Panama - the Executive Council could undertake the negotiations in question, under the direction and guidance of the Economic Council.

The agreements thus drawn up would imply the signature of five identical documents, one for each country, which would be submitted to the respective legislatures and would enter into force when all the instruments of ratification had been deposited. In the aggregate, the formalities involved would not be unduly time-consuming, if measures were adopted like those outlined with reference to the flexibility of the common import tariff.

Admittedly, this procedure could not permanently meet the requirements of a trade policy of fully Central American scope; but at any rate, it would enable immediate needs to be served, and above all would provide a  
/means of

means of acquiring the experience that the area wants, so that more efficient procedures could ultimately be established for the internal co-ordination of the five countries interests, and the concerting of a united position vis-à-vis other countries. On this basis, it would be possible to agree upon the terms of the relevant Central American Integration Treaty that would indubitably have to be concluded.

/III. SECTORAL



### III. SECTORAL PROGRAMMES AT THE REGIONAL LEVEL

To endow Central America - considered as an economic unit - with material services and facilities and with a production capacity commensurate with its size, as a starting-point for the long-term metamorphosis of the member countries' development pattern, is one of the pivotal tasks of the Central American economic integration movement. In Central America's case, the integration process differs from its counterparts in countries which already possessed a highly-developed production system before establishing their common market, much in that remains to be done in this direction, and there is still a marked shortage of resources and basic investment, alongside heavy costs and inadequate public utilities split up among the individual countries.

By virtue of the studies undertaken so far, the nature of the tasks ahead has been clarified, together with the magnitude and characteristics of the problems entailed, and some of the measures that need to be adopted. At the same time, progress has been made by the Governments in the technical and financial aspects of a group of regional programmes, relating to transport, communications and electric power.

The implementation of these programmes, however, has not yet begun. Too short a time has elapsed since the common market was established for any spectacular achievements to be expected in this field. But in addition, difficulties have arisen that are slowing up and hindering the execution of regional investment programmes. This state of affairs is arousing justifiable concern, since the end of the interim period allowed for bringing the common market into full operation is now close at hand.

If things go on in the same way, Central America will be throwing away the opportunity of using the market's present dynamic force in the furtherance of important economic adjustments that ought to be made. In the following pages, the obstacles are reviewed and the measures needed to overcome them are discussed.

1. Regional programmes in relation to the development  
of the common market

The progress made by the common market could not be more satisfactory as regards the dynamism and continuity of the expansion of trade among the five Central American countries. But the structure of this intra-area trade, and the patterns followed by the investment from which it stems, bear witness to the fact that free trade and a common tariff are not enough to generate sustained development over the longer term.

Up to now, the rapid growth of inter-Central American trade has reflected an import substitution process based on a structure of production essentially national in its characteristics. The effects of this process are sure to be prolonged for several years, and will swell trade flows until much larger volumes are registered than at present. Indeed, it seems likely that through the adoption of measures to make free trade arrangements flow more smoothly and improve the efficacy of the common import tariff, intra-area trade may continue to expand until existing volumes are doubled, and may even reach an annual value of about 250 million dollars.

But once the additional demand created by the common market is exhausted, the latter's dynamic growth can only be maintained if the regional economic unit manages to establish new trade opportunities, increases the efficiency of the production system and secures access to external markets for new Central American export lines. Whether it does so will largely depend upon how far it is successful in developing its resources on a basis of cost reductions and maximum exploitation of economies of scale. Herein lies the importance of sectoral programmes at the level of the area as a whole, since a regional approach to the development of the economic infrastructure is an indispensable requisite for bringing down real production costs.

The attainment of these ends will be contingent not only upon the implementation of the programmes in question, but also upon the adoption of appropriate methods of putting them into effect. For example, if in drawing them up definite recognition were accorded to the needs of the

/relatively less-developed

relatively less-developed countries, and if they were executed by means of joint action at the regional level, they would do much to promote a development process whose inter-country balance was safeguarded, and at the same time to spur on the economic integration movement.

2. Regional programmes: present situation  
and general problems

The following are the principal undertakings for which the Central American Governments have been formulating programmes: the Central American highway plan; the Central American telecommunications network; and the interconnexion and joint development of electricity systems. Generally speaking, satisfactory progress has been made as regards the study and technical and economic evaluation of these programmes, and in almost every case the stage prior to the drafting of the final projects has been reached.

(a) Financing

Thanks to the action taken by the Central American Bank and other international credit institutions, no major difficulties seem likely to be encountered in obtaining the external financing required for the above-mentioned investment projects. For a time, the financing of local expenditure did constitute a fairly serious problem; but the obstacles in the way were largely removed by the constitution of the Central American Integration Fund, which was established early in 1965, and provided a means of securing all the financial resources needed for projects of regional interest.

The over-all problems relating to longer-term financing of integrated development call for careful study, with due regard to the clause in the Charter of Punta del Este which stipulates that external credit for the financing of regional programmes should be additional to loans for purely national programmes. If this clause is to become operative, it would not be enough merely to place supplementary international credit lines at the disposal of the Central American countries. The terms on which such loans are granted would also have to be adjusted to the area's real borrowing capacity. Similarly, the inter-country allocation of funds should be

/effected on

effected on the basis of amortization periods and rates of interest consistent with each country's capacity, the latter being determined in relation to the total external credit requirements of the country concerned.

The constitution of the Integration Fund represented a considerable step forward in the first of these directions, because of the favourable terms it offers in respect of rates of interest, moratoria and amortization periods, and the proportional size of the five countries' contributions. But only a study of aggregate external financing requirements and of the over-all characteristics of existing external debts could provide the background material for a decision as to whether the structure and operation of the Fund should be maintained as they are or amended. Moreover, the establishment of more favourable terms for the less developed countries is a question which has not yet been mooted. This avenue should be explored, for the fate of a regional development policy designed with a view to balanced growth might well depend upon the adoption of such provisos.

(b) Unilateral action, co-ordinated action and joint action

The main difficulties that have cropped up in connexion with sectoral programmes at the regional level have arisen in fields other than that of financing, and underline the need for other requisites of equal or similar importance to be fulfilled before a real start can be made on the executorial phase. Some of these problems are peculiar to individual sectors, but others are common to most or all, in varying degrees of intensity.

So far, the most widespread difficulty has been that of placing a genuinely regional stamp on the programmes. Here a distinction can be drawn between those in which a Central American agency - for example, a regional telecommunications authority - is to be established from the outset, and those in which the immediate task is to standardize policies and co-ordinate decisions at the level of the area as a whole, for subsequent implementation locally, as in the case of the Central American highway plan.

/In the

In the first instance, the task in hand is to establish procedures for the transfer of a public function to official agencies at the Central American level. Any policy decision of this kind must be given practical expression in legal and organizational instruments which, apart from their own intrinsic efficacy, will ensure that member Governments really take part in directing the activities of the new bodies, will clearly define the terms of reference of these latter, and will reconcile the interests of the five countries. In this connexion, the difficulties that have arisen in some of the sectoral programmes are partly attributable to the fact that the technical and economic studies carried out beforehand were not accompanied by thorough research in the legal, administrative and organizational fields.

In the second case, the objective is not the joint discharge of a public function, but its organization on such lines that each Government continues to exercise it independently, subject to guiding principles, specifications and co-ordination arrangements agreed upon multilaterally. Here, then, the problems are of a different kind. They relate to the establishment of a minimum level of co-ordination to ensure the smooth and punctual implementation of the programme, with due allowance for the conflicts deriving from the tendency of member States to give local projects priority over those of importance for the Central American area as a whole. In such circumstances, the solution lies partly in differentiating between those aspects of the work that need co-ordination and those whose execution can be left to unilateral decisions on the part of each Government, and partly in recognizing that most of the activities it is sought to establish at the regional level supplement rather than supersede those of a national character.

To meet all these requirements is no easy task. But precisely in so far as it proves impossible for the sectoral programmes to be drawn up and implemented as a joint or co-ordinated effort, the Central American countries by themselves will likewise be unable to take advantage of the major opportunities and needs created by their own integration movement.

/In this

In this sense, even the co-ordination of national programmes on a regional basis can be thought of only as a stage which will later have to be succeeded by the organization of purely Central American activities. Although the resources available in each individual country may perhaps suffice for what has to be done at the national level, they are patently inadequate for the execution of more far-reaching projects. Pooling them, on the other hand, might multiply their potentialities and thus create more favourable conditions for integrated development.

Somewhat paradoxically, it is precisely here that the most formidable stumbling-blocks in the way of sectoral programmes at the regional level are encountered. All these programmes without exception - those relating to highways, to telecommunications and to the interconnexion and development of electricity systems alike - are affected by factors that obstruct the dovetailing of national activities in a joint regional effort.

There is no reason to suppose that these factors will ultimately prove stronger than the endeavours made to combat them. The capability which the five countries repeatedly displayed in overcoming the obstacles to the formation of the common market, together with unswerving adherence to a pragmatic rather than a doctrinaire approach, based on sound technical foundations, will provide the means of devising favourable and efficacious expedients. But whatever the outcome of the efforts made, the future of integrated development in Central America will obviously, in the last analysis, be contingent upon the fate of sectoral programmes at the regional level.

(c) The role of national agencies

The objectives pursued would be easier to attain if it were recognized that progress on a regional scale can only be achieved through the intensive participation of national agencies and institutions. A whole range of such bodies, other than those whose collaboration has traditionally been available, must wholeheartedly enter into the work of economic integration. Experience shows that the programmes in which most headway has been made are also those in which the most active part has been played by the appropriate national agencies.

/Not only

Not only must the activities of such institutions, once they are established, be effective from the intrinsically technical standpoint; they must also be brought into line with the principles and policy of the Central American integration movement. Obviously, this will take time, but it is equally clear that the initial assimilation period could perhaps be shortened if co-operational links were established with the more experienced agencies - the Economic Council and the Executive Council -, as was suggested in the context of the institutional organization of the integration movement.

(d) Shortage of personnel

One of the crucial problems affecting sectoral programmes of regional scope is the shortage of technical resources for their implementation. In the first place, national agencies are hindered from participating in integration activities by their natural reluctance to switch over the services of the limited staff they have at their disposal for coping with their more immediate responsibilities to regional projects which in some cases are apparently longer-term and less urgent undertakings. Secondly, the shortage in question makes it particularly difficult to improve the technical basis of the new organization proposed, in default of which the efficacy of joint governmental action would suffer, and the execution of regional programmes would thus have less chance of being crowned with success.

Hence emerge certain conclusions worth noting. Firstly, a selective approach must still be adopted to the promotion of programmes, which must be scheduled in accordance with their importance and urgency from the integration standpoint, the relative headway they have made, the availability of internal resources and the existence of interests common to the member countries. Otherwise, the dissipation of the scanty resources available would inevitably mean that out of a whole set of programmes, each highly important, none would be pushed on to the decisive phase of execution.

Secondly, not only will Central America continue to need external technical assistance in the immediate future, but its requirements in that respect will expand considerably. This, of course, raises the problem of how to obtain the resources wanted and, above all, how to furnish the necessary domestic resources to complement those procured from abroad. An

/indispensable requisite

indispensable requisite will be to assign regional functions to a minimum cadre of highly-qualified personnel, and to arrange for great freedom of movement on the part of the best Central American experts, with a view to the formation of a sort of Central American technical corps to support the external advisory services.

Lastly -- and this is perhaps the most important point --, Central America has not yet embarked upon a far-reaching and energetic effort to train technical, executive and administrative personnel, so as to eliminate the existing bottleneck and still further strengthen the area's capacity to absorb external resources. By itself, such an effort would not suffice to make the region's sectoral programmes dynamic and effective, and might even encourage the emigration of qualified specialists to other areas. But if it were planned and carried out in close relation to investment programme requirements and to integration activities in other fields, it would do much to further not only the installation of material facilities for the common market, but also, in particular, the endowment of Central America with the planning and executive capacity to complement, expand and reinforce them, as and when requirements increased in extent and variety.

### 3. The Central American highway plan

#### (a) Background data

Most of the Central American countries have made remarkable progress in respect of road communications. During the last ten or fifteen years, the road network has grown considerably, and many highways have been improved, so that new areas have been opened up for production purposes and better connexions with the consumer centres have been established. Similarly, up-to-date techniques have been introduced in some of the Government agencies whose jurisdiction extends to this sector, and a start has been made on the development of national public works enterprises. Thus, the present state of affairs is very different from that prevailing in 1952, when a United Nations technical assistance mission carried out the first systematic study of transport in Central America.

/The advances



The advances achieved have really been based on the previously existing transport systems - mainly designed to serve the needs of foreign trade -, and form part of a national development pattern by virtue of which higher levels of internal integration have been reached in each of the individual countries. From the standpoint of the regional integration programme, on the other hand, the headway made has been only slight, and, such as it is, represents the outcome of government action to deal with national problems. Nevertheless, it has sufficed to provide - ever since the fifties - a minimum basic network of highways usable for regional purposes, although the common market has not yet been endowed with a road system that fully meets its requirements.

It must be remembered that so long as no intensification of inter-Central American trade flows and other economic links took place, the construction of such a road system was bound, up to a point, to be given second priority. The situation was radically altered by the entry into force of the General Treaty on Economic Integration, or even earlier, when the growth rate of trade began to gather speed in response to bilateral treaties and to the very prospect of the formation of the common market. A road network of Central American dimensions then became a primary need, and the remedying of the relative lack of road communications in Honduras was seen to be of great importance, as a key factor both for the efficacious operation of free trade throughout the area and for the preservation of the balance of development in Central America as a whole.

The programme for the construction and improvement of the Central American road network has gradually taken shape as a result of the studies carried out by the Central American Transport Sub-Committee, and covers thirteen highways which are considered to be of regional importance. Since 1963, the formulation of a highway plan for 1965-74 has been in progress, with the direct participation of the Ministers for Public Works and for Economic Affairs, and the technical advisory assistance and active co-operation of the Central American Bank, SIECA and the Joint Programming Mission. More recently, with the help of two firms of consultants, new and more extensive studies have been carried out, whose findings may provide guidance for such activities in the future. Headway has also been made in the preparatory work for a regional road maintenance programme.

/(b) Objectives

(b) Objectives

The aim of the highway plan is to complete the Central American road network so that, through the betterment of existing road communications and the construction of new highways, the following objectives may be attained: (i) improvement of the quality and flexibility of motor vehicle transport services within the common market, so that the main centres of consumption and of industrial production may be more closely linked up; (ii) establishment of new ocean-to-ocean routes in the north of the area, to facilitate the movement of goods involved in foreign trade, and, in other cases, construction of less costly alternative routes; (iii) connexion of specific production areas, mainly agricultural, with regional consumer centres; and (iv) equipment of Honduras with a basic network of arterial highways which will also serve to diversify its links with neighbouring countries.

(c) Progress achieved

The technical studies carried out have made it possible to demarcate the extent of the network more precisely; to prepare a provisional estimate of the investments required; to evaluate their economicity, by means of provisional calculations of the cost/profit ratio in each case; to reach multilateral agreement on schedules for the various projects; and to establish bilateral committees to co-ordinate the work, in respect of compliance with schedules, building of international bridges, interconnexion of highways and standardization of design and construction specifications. The Central American Bank, on its part, has begun granting loans for the completion of a number of project studies, and with the establishment of the Central American Integration Fund, it has become possible to introduce a new project-financing procedure and provide resources for the execution of the initial works.

(d) Problems outstanding

(i) Financing. The most immediate financing problems have been solved by the creation of the above-mentioned Fund. For the moment, however, its resources are limited, and seem insufficient to finance the first stage of the highway plan. Since, in addition, the Fund is open to the claims

of many other integration projects, it is clear that still further action will have to be taken in order to finance the greater part of the plan, and the work schedule agreed upon may possibly have to undergo modification.

One way of obtaining the financial resources wanted - external and internal - lies in using the machinery of the Fund and expanding it continually as the original resources are applied. But to enable the countries to carry out the highway plan as efficiently as is to be desired, and to organize their actions in terms of the needs that arise, the element of financial uncertainty should be eliminated, so that attention can be concentrated on the work involved in the actual execution of the plan.

It must be recognized that Central America would be throwing away some of the opportunities open to it for the financing of regional investment projects, if, as a result of using Integration Fund resources for road-building, it failed to draw upon external sources of financing accessible on similar terms for the same ends. This does not mean that the idea of financing the highway plan through the Fund should be rejected, or that the latter should withdraw its support from projects of other kinds. In fact, the establishment of this instrument may well represent an essential step forward in the process of guaranteeing and improving the terms on which the region's integrated development will be financed in the future.

Nevertheless, if maximum advantage is to be taken of financing possibilities, the Fund should not be strengthened only by the periodic contributions of the member countries and of other Governments. It could also receive and channel increasing volumes of resources provided by international agencies and private sources of external credit, on the basis of regional programmes formulated and agreed upon multilaterally.

(ii) Regional co-ordination. The most immediate difficulties besetting the execution of the highway plan stem from the lack of regional machinery to ensure the consistent and timely implementation of the programme, and from the limitations of the technical and organizational capacity available for the planning and execution of the works themselves. The problem of co-ordinating the plan at the regional level has two separate facets.

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In the first place, complete agreement has not yet been reached among the five countries with respect to investment priorities and implementation schedules. Particularly in the case of Honduras, it would seem essential to clarify the position as regards the relative importance assigned to public investment in regional highways and to other requirements in respect of highways of purely local interest, approach roads and other infrastructural sectors. In turn, a decision that would facilitate the execution of the highway plan might be linked (a) to the granting of funds for the part corresponding to Honduras on terms which would not unduly cripple the country's borrowing capacity in relation to urgently-needed public investment in other important fields; and (b) to the adoption of supplementary measures, likewise designed to bridge the gap between the stage of development reached by Honduras and that attained by the other members of the common market.

Secondly, even if the five Governments were to reach complete agreement on the nature, scope, timing and priority of the projects, it would not be enough to ensure the execution of the highway plan in conditions that were completely satisfactory from the regional standpoint. In order that such an agreement may be translated into effective action, it is essential to establish organizational patterns whereby, if sufficient technical resources are made available, national activities can be adopted, dovetailed and supported in the light of Central American considerations and requirements. To this end, it is necessary to co-ordinate and integrate the action of three leading types of agency: the Ministries of Public Works, the Central American Integration institutions, and private firms, inside or outside the area, concerned with the design and construction of highways.

(iii) Central American Transport Council. So far, national agencies have played their part in the highway plan through the Central American Transport Sub-Committee and the joint conference of Ministers for Public Works and for Economic Affairs. But once the over-all studies have been completed and the time has come to embark outright on the preparation and the actual execution of projects, their role must be strengthened and given

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continuity. The conference of Ministers for Public Works should therefore be institutionalized through the establishment of a Central American Transport Council, and a regional commission, composed of Directors of Highway Departments or of Public Works, should be set up to assume responsibility for endowing the common market with a regional road network, and, subsequently, for other infrastructural construction works.

Acting in conjunction, the Ministers and Directors of Public Works could (a) expedite the completion of the project studies and designs; (b) promote full utilization of the scanty technical resources available, by ensuring the regional mobility of national experts and guiding the activities of the joint committees; and (c) encourage the creation or, as a continuing function, the evaluation and review of common market road and execute road works at the regional level. They could also undertake, as continuing function, the evaluation and review of common market road requirements during later stages of the integrated development of Central America.

It should be stressed in this connexion that the road network programmed only partly covers the material and economic needs of regional integration. As this process advances, the system will have to be improved and diversified by the addition of connexions and routes that will open up new production areas, facilitate foreign trade and still further accelerate the expansion of inter-Central American trade flows, as part of a broader approach taking into account the alternative possibilities offered by other means of transport.

(iv) Technical cadres. For the efficacious performance of all these tasks, the top-level agencies and officials would need to have at their disposal technical cadres engaged exclusively in collecting the data required and giving the necessary advisory assistance in their special fields. This has been the function discharged in recent years by SIECA and the Central American Bank, with the support of the Joint Programming Mission. The small number of experts assigned by these institutions to the highway plan is not commensurate with requirements, and should be substantially increased, so that impetus can be given to activities that will no longer be sporadic or carried out at regular

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intervals, but will entail the intensive and continuing effort involved in a full-time drive to complete and put into effect all aspects of the highway plan.

This is also an essential requisite for the guidance and integration of the work of private bodies such as firms of consulting engineers and road-building enterprises, as well as for the utilization of the experience acquired in organizing Central American agencies which, as time goes on, will play a growing part in programmes of this kind. The need for external co-operation would thus be combined with the necessity of adapting it to Central America's requirements and the aim of creating internal expertise. In this connexion, the activities of both the joint SIECA/Central American Bank group, which has carried out preliminary studies on the thirteen highways comprised in the road network contemplated, and the SIECA/Central American Bank/Joint Programming Mission committee, which has been co-ordinating and directing the over-all transport study undertaken by two private firms of consulting engineers, constitute valuable experience and pave the way for the broader tasks that still remain to be accomplished.

#### 4. Regional road transport services

The improvement and expansion of regional overland transport services, in combination with the reduction of the cost and price levels prevailing in the common market, is perhaps an even more urgent need than the completion of the Central American road network itself. As from the end of last century, with the development of the agricultural export economy, railways came to constitute the chief means of goods transport used in Central America. But during the past two or three decades, as the countries of the area have established better road networks and reached higher levels of internal integration, motor vehicle transport has gained in importance, and nowadays constitutes the means of conveyance on which the inter-Central American trade basically depends.

##### (a) Overland transport costs in relation to the development of the common market

The economic picture presented by the transport sector could hardly be more heterogeneous or vary more widely from country to country and even

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from one enterprise to another. The common denominator of all such services in Central America as a whole is the fact that they operate at much higher cost levels than in other countries, even those included in the relatively less developed group.

What is more, as a general rule intra-regional transport is even more costly than the corresponding services within each country's frontiers, owing to the additional expenses deriving from customs formalities, care of goods in transit and the difficulty of making sure of a return load. The high costs are also attributable both to the level of freight charges and to the shortcomings of the services concerned in respect of quality, regularity and time schedules.

This situation creates obstacles to free trade, hinders the establishment of a regional supply and passenger transport system, and limits the efficacy of the legal and institutional measures adopted to promote the economic unity of Central America. The difficulty of reducing long-distance costs partly accounts for the concentration of inter-Central American trade in the three northern countries of the area.

The state of affairs described also militates against the establishment of the structure of industry on a regional basis. In the first place, it restricts the possibilities of supplying certain productive activities with raw materials and inputs processed in other member countries. Secondly, it hampers the consolidation of integration industries and, in general, of any others installed with a view to serving the area as a whole.

(b) Characteristics of regional services

The execution of the highway plan will make for the generation of savings and the creation of conditions conducive to lower costs and prices. But the main short-term causes of the problem lie in the organizational defects of the transport services.

As a result of the economic integration process, various freight and passenger transport services operating among the five member countries are beginning to spring up; but partly on account of uncertainty as to the permanence of the traffic concerned, and partly because of the very characteristics of an incipient industrial structure, no clean-cut line of demarcation exists as yet between transport services and production and

/manufacturing activities.

manufacturing activities. Thus, specialized enterprises are to be found in Central America alongside private commercial services operating marginally, and individual carriers.

This situation would be no more than the reflection of a transitory phase of the integration movement, but for the existence of factors liable to perpetuate it and prevent the development of satisfactory services. In practice, the widespread tendency to develop transport on the basis of purely national efforts, in combination with unrestricted freedom of access to the industry in question, is splitting up the transport sector into far too many undersized operational units, and is giving rise to ruinous competition, particularly detrimental to the specialized enterprises.

High as they are in relation to the value of the goods carried, the freight charges prevailing are low in comparison with what these transport services cost to produce, and reflect defective management, the use of unsatisfactory equipment, the want of minimum maintenance and replacement programmes, and the limited financial capacity of the enterprises concerned. All this affects the quality of the services and at the same time discourages the process of capital formation in the transport sector.

(c) Need for action to regulate inter-Central American transport

The experience of many countries shows how unlikely it is that the deficiencies noted will remedy themselves of their own accord. Hence the necessity - intensified by the economic development process - of establishing a transport regulation and control system. Such a system is virtually non-existent in the Central American transport sector, except for specific provisions relating to passenger transport and a few traffic regulations and rules concerning the safety of vehicles.

At the regional level, there is a complete lack of freight regulations, and in the case of passenger transport, the current practice is to apply national provisions to inter-country services. This naturally makes for the duplication of routes, the extension of too many concessions and, in general, unsatisfactory terms of competition. It seems necessary, therefore, to introduce regulatory public action

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to direct, promote and organize the development of inter-country transport services.

The problems referred to were not an unexpected offshoot of the economic integration process. From 1955 onwards, the traffic authorities and the Economic Co-operation Committee itself have drawn attention to the desirability of concerted action and have formulated specific guiding principles, some of which were incorporated in the Multilateral Treaty, in the General Treaty, and in the agreements on road traffic and temporary importation of vehicles. Against this background, the four years of the interim period that have elapsed have only confirmed the need for such directives, while at the same time still more light has been shed on the nature of the measures to be adopted and the fields to which they should relate.

(i) Transport tariffs. The regulation and standardization of the tariffs in force for transport services among the five countries is a task that should be tackled at once, despite the complex problems it raises. These relate to the determination of the factors that must be taken into account in drawing up the tariffs, and to the regulatory system that should be adopted, both from the standpoint of tariff levels and from that of organizational patterns and administrative procedures to ensure conformity. Here again, as soon as this type of analysis is attempted in any depth, it can at once be seen that various measures need to be introduced to regulate the issue of concessions and the operation of transport services, as well as to promote the establishment of efficient enterprises through the consolidation, modernization and expansion of those already in existence.

(ii) Control of access. One of the essential requisites is to control the issue of transport service concessions. Apart from the drawbacks of permitting the indiscriminate incorporation of new enterprises, the actual efficacy of tariff provisions is contingent upon the adoption of measures of this type. In the first place, the various categories of services must be defined and differentiated, especially those provided by public corporations as against private activities. It will thus be possible to classify transport enterprises,

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and to channel commercial transport operations exclusively through the public services. Secondly, a clearly-defined system of routes for inter-country transport should be demarcated and brought into use, - concessions non-transferable in character - being granted only to companies meeting the minimum requisites established to guarantee the efficiency of the services provided.

(iii) Quality of services. The adoption of levels and margins applicable to transport tariffs would be meaningless, and attended by administrative difficulties, unless at the same time the type of service concerned, and its characteristics, were specified. Moreover, in establishing the right conditions to ensure a reasonable structure of competition, it is essential to safeguard the users' interests likewise, as regards the nature and quality of the services they will have at their disposal.

In the initial stage, only a minimum of regulations should be adopted, relating (a) to the service capacity of enterprises; (b) to the establishment of itineraries; (c) to the control of discriminatory practices; (d) to procedures for co-operation among different enterprises; and (e) to foreign investment in this field.

(iv) A Central American agreement. The foregoing major aspects of the overland transport problem deriving from the economic integration movement serve as pointers to the tasks that should be undertaken at the meeting of government officials recommended by the Economic Council in the course of its eighth special session. A specific work programme could be adopted on that occasion, and the technical bases could be established for the formulation of an agreement on this subject and of the regulations for its application. A provisional régime could also be drafted, to fill the gap until the necessary institutional and legal instruments are prepared and brought into operation.

In view of the eminently regional character of overland transport problems within the common market, provision must be made for the establishment of an executive agency at the Central American level to assume responsibility for the administration of the agreement. Another indispensable requisite will be the active participation of entrepreneurs

in the transport sector and of transport service users. To this end, it seems appropriate that they should be encouraged to organize associations and should be represented in the formulation of the agreement, as a means of ensuring the voluntary co-operation of the private sector and, at the same time, safeguarding the interests of the various economic groups concerned.

## 5. Central American telecommunications system

### (a) Background data

The telecommunications systems of the Central American countries are basically the same that were established when the agricultural export economy came into being. Cable and wireless communications with countries outside the region were developed by foreign companies, in close connexion with the growth of the banana industry. Telegraphic services in their turn were expanded as the national governments consolidated their position, and telephone networks were constructed, mainly to meet the needs of the capital cities.

After the Second World War, when the urbanization process acquired fresh impetus and production was diversified to some extent, it became obvious that these systems were inadequate, either on account of their relatively limited capacity or because of the increasing obsolescence of their plant and equipment. This induced several of the Central American Governments to modernize the telephone services in their respective countries during the fifties, expanding them in the capitals and improving connexions with the most important population centres.

The formation of the common market, and other advances achieved by the integration movement, made the establishment of regional telecommunications services a requirement to be met by means of joint action on the part of the five countries. At that time, no satisfactory intra-regional communication media were available, and even now telephone calls have to be put through via third countries, while several national and Central American institutions have found themselves obliged to establish their own radio services with small-scale equipment of limited capacity.

### /(b) Progress

(b) Progress achieved

Since 1961, the Central American Governments have devoted themselves to study the technical and economic problems involved in the modernization, expansion and interconnexion of their national telecommunications networks. The International Bank for Reconstruction and Development (IBRD) and the United Nations Special Fund, through an expert mission, have carried out technical studies at the request of the Governments themselves. These studies have already reached the stage immediately preceding that of the engineering designs, and deal with matters relating to the development of services both in each individual country and in the region as a whole. Thus, what is envisaged is not merely a series of dissimilar although directly interconnected systems, but an integrated network with which each country would be linked in the initial stage, and in relation to which all the national networks could be developed on a co-ordinated basis. It has also been shown that such a regional telecommunications network could provide a means of connecting up the area with the systems of the United States and South America, so that advantage could be taken of the resulting increase in traffic to reduce investment amortization periods. Moreover, in view of the interest in this project displayed by some of the international credit institutions, financing questions have at no time figured as an obstacle to the execution of the plan.

The proposal has been made that a Central American enterprise should be established to construct and manage the regional telecommunications network. It would service the national companies already in existence, and, as far as can be seen at present, appears to be the most advantageous solution of the problem, both as regards the efficiency of investment and from the standpoint of ensuring a satisfactory intra- and extra-regional service. Nevertheless, despite the efforts made by the national authorities in the course of several meetings, it has not been possible to overcome certain difficulties, or to reach an agreement whereby the organization of the enterprise in question could be given legal form.

/(c) Problems

(c) Problems outstanding

Among the problems of which mention should be made are those concerning the determination of technical specifications for plant and equipment; the evaluation of the recommendations presented in the studies with respect to the capacity and general technical characteristics of the regional network; and the detailed study of the possibilities for its interconnexion with the Panamerican system and with the Inter-American Telecommunications Network (ITN).

Thus, certain difficulties exist which will have to be cleared up before the project can be executed; but these are not the obstacles that are hindering progress. It is not on account of considerations relating to the technical characteristics of the system that work has come to a standstill, since its advantages over any solution at the national level are fully recognized. Rather is it in the attempt to agree upon the legal and organizational patterns which would have to be adopted in order to put the project into effect that the stumbling-blocks have arisen. They presented themselves primarily in connexion with the choice of the country where the projected enterprise was to be located; the criteria that should govern the distribution of its profits among the member countries; and the relations between this new body and the other economic integration agencies. These and other considerations, in combination with the urgency of several countries' need to improve their own networks, have induced some of the Governments to envisage bilateral interconnexion of national systems as an alternative to the regional project.

This question cannot be settled without due regard to the shortcomings of independent and unilateral action as a means of tackling requirements which can only be satisfied through joint action of Central American scope. If the regional project were discarded, there would be no chance of creating conditions that would enable part of the telecommunications traffic of the whole continent to be channelled through Central America. The economicity of investment would thus be unnecessarily reduced, through failure to take the opportunity of obtaining substantial income under this head.

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Nor would these be the worst consequences. Bilateral interconnexion has many drawbacks, including, in particular, the following: (a) comparatively higher costs, and probably higher tariffs too; (b) reduced efficiency, in respect of both the capacity and the quality of the services; (c) greater difficulties in connexion with the expansion of services in the region as a whole; (d) heavier investment requirements for the purposes of increasing interconnexion facilities; and (e) more serious obstacles to gradual standardization of the technical characteristics of the national systems.

On the other hand, notwithstanding the considerations previously adduced, the problems connected with the organization of a Central American telecommunications enterprise do not seem insoluble. It is very largely true that the difficulties have not been overcome because up to now neither they nor the situations they reflect have been analysed with sufficient thoroughness.

When the technical and economic studies had been completed, research work was not pursued with a view to covering legal and organizational questions equally comprehensively and in the same depth. In other words, bases were not established either for the statutes of the enterprise, in respect of co-ordination of the interests involved and connexions with the national legislation in force, or for the fulfilment of the function of regulating telecommunications services in Central America.

This case is one of the clearest illustrations of the fact that for the execution of a project technical and economic studies are not enough, and affords an example of a regional programme that has been unable to make satisfactory progress precisely for want of the background data and other material required in order to provide an appropriate legal and administrative framework for a new public utility service at the regional level.

Accordingly, fresh endeavours should be made to proceed with the construction of the Central American network and the establishment of the corresponding enterprise through co-operation among the five countries. It would not be a question of conducting additional

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negotiations solely on the basis of the material already available, but rather of adducing new background data, deriving from studies and technical advisory assistance activities, on problems not so far analysed. Apart from those mentioned above, study should be devoted to the problems concerning the interests of the telecommunications companies established in each individual country, and the participation of the national authorities not only in the determination of guiding principles - already laid down - for the activities of the new corporation, but also in all decisions connected with the construction of the regional network, including the establishment of terms and conditions for the presentation of tenders, the purchase of equipment, etc. In this way, the difficulties encountered hitherto could probably be overcome, and it would not be long before an agreement could be signed which would ensure the attainment of the technical and economic benefits inherent in a regional project.

(d) Other questions

This does not mean that activities relating to other aspects of the regional network must be deferred until final decisions on the organization and functions of the corresponding enterprise have been adopted. For example, the studies on specifications for the various sections of the regional network, the evaluation of the recommendations put forward in relation to its general technical characteristics, the analysis of the requirements entailed by connexion with the Inter-American Network, and the formulation of alternative procedures for the financing of investment, could all be continued without interruption. For these purposes, the Central American countries could obtain adequate technical assistance from abroad, which would, moreover, immediately enable them to find a way out of the impasse created by the difficulty of reaching agreement on specific provisions of the legal instrument establishing the corporation.

The lines along which this matter of the over-all telecommunications network has developed exemplify a problem that also affects other sectoral programmes at the regional level. There has been a tendency to approach the telecommunications question separately, as if it had no bearing on  
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the Central American common market. Nothing could be more prejudicial to the interests of the integration movement, or even to the individual countries. It should not be forgotten, therefore, that the imperative need to expand the telecommunications services among the five countries stemmed precisely from the economic integration process, and that consequently the regional network must be designed to serve the requirements of Central America as a whole.

Hence two practical conclusions can be drawn. In the first place, joint meetings of the Economic Council and the national telecommunications authorities would help to ensure co-ordination of common market requirements with the possibilities afforded by this branch of the economic infrastructure. Secondly, whatever the organizational patterns ultimately adopted, the development of the regional network should be promoted in conformity with the following minimum requisites: (a) standardization of the technical characteristics of systems, equipment and materials, in order to facilitate the immediate interconnexion of services and their future expansion as and when national and regional requirements increased; (b) standardization of operation and maintenance systems, in order to guarantee the fullest possible utilization of installed capacity, and satisfactory transmission conditions at all times; and (c) alignment of tariffs, with the aim of establishing the same prices throughout the region for the same types of services.

#### 6. Hydroelectric resources and interconnexion of electricity systems

##### (a) Background data

Electricity services began to develop in Central American early in the present century, at first in the form of municipal services, which soon proved inadequate to meet the growing requirements of the individual countries. Larger-scale private enterprises were then established - generally as subsidiaries of foreign companies -, which increased installed capacity, expanded transmission and distribution networks, and consolidated a major proportion of the locally installed facilities in interconnected systems. As they were based to a great extent on thermoelectric plants, these systems were not conducive to more efficient

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utilization of the Central American countries' water resources, which constitute their chief potential source of energy.

As time went by, different causes - which included the world depression of the thirties, and governmental and company policies - halted the growth of the electricity systems, while demand continued to increase. The piling-up of requirements during the Second World War, and the economic boom which followed the cessation of hostilities, gave rise to an acute shortage of electric energy and a widespread deterioration in the quality and regularity of the services provided.

Early in the fifties, almost all the Central American Governments began to formulate electrification programmes and to put them into effect. Thus, the countries of the area succeeded in establishing their own national institutes; training technical and administrative cadres; promoting investment in new generation, transmission and distribution systems; encouraging the utilization of hydro-electric resources; and, in most cases, covering a large proportion of the unsatisfied demand accumulated in previous periods, while at the same time improving supply conditions.

Nevertheless, the small size of the different national systems, together with the characteristics and potential of the resources harnessed, have resulted in levels of capacity, costs and tariff rates that are incompatible with the provision of services for the bulk of the population and the raising of per capita electricity consumption to standards comparable with those attained in other countries at similar or more advanced stages of development. For the same reasons, there is also little likelihood of the electricity systems' becoming a dynamic factor in the promotion of industrial development on a regional basis, especially where the establishment of highly power-consuming producer activities is concerned.

(b) Progress achieved

The national electricity authorities began to hold meetings, as from 1955, and later (in 1959) decided to set up a Central American Electrification Sub-Committee under the Economic Co-operation Committee, formulating and adopting a specific work programme. At the start, this  
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programme was directed towards the preparation of comparative studies on the situation of the electricity sector in the five countries; the improvement and organization of statistical information systems; and the analysis of electric power costs and the differences observable in this respect from one country to another.

The first results obtained enable integration activities in the electricity sector to be channelled along increasingly definite lines, and led to the preparation of studies on the more immediate possibilities of interconnexion between given pairs of countries. At the request of the Sub-Committee, United Nations experts carried out a detailed technico-economic survey of the central networks in Honduras and El Salvador, and presented preliminary comments on the establishment of a bi-national system in the frontier zone between Panama and Costa Rica. Subsequently, they prepared a comprehensive study on the interconnexion and combined development of Nicaragua's Pacific system and the central network of Costa Rica. At the present time, the possibilities for interconnexion between Guatemala, Honduras and El Salvador are being investigated, and research has begun on electricity supply problems in other frontier areas and on feasible projects for the linking-up of Central America with other countries, particularly Mexico.

The Honduras-El Salvador Project, approved in principle by the Governments concerned in 1963, would give rise to substantial transfers of energy from the lago Yojoa-Rio Lindo system (Honduras) to the Rio Lempa network (El Salvador), besides supplying the south of Honduras by means of the facilities installed in El Salvador. In the light of the initial basic research, and with the financial support of the Central American Bank, a private firm of consulting engineers has completed the technical and economic project studies. In addition, further negotiations between the interested Governments have taken place, and the construction works can be started as soon as both parties have adopted their final decisions.

The Nicaragua-Costa Rica Project was submitted to the consideration of a Working Group formed by representatives of the electrification agencies of the two countries. On that occasion, the main aspects of the project

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were discussed, and it was decided to proceed jointly with the studies, for the financing of which application is being made to the Central American Bank. The preliminary study on the possibility of supplying the south of Costa Rica with power from the frontier zone of Panama served as the basis for a fuller survey which was incorporated in the United Nations Special Fund project for the development of the water resources of the rivers Chiriquí and Chico (Panama).

Thus, a possible strategy for the promotion of electrification in Central America has been gradually taking shape. The evidence gathered confirms the necessity of basing the development of the sector on the use of the area's abundant water resources. This does not preclude the appropriate utilization of thermo-electric energy, on a selective basis.

Another obvious need is to construct larger systems and to harness, irrespective of their geographical location, those water resources that offer most advantages, especially international waterways and high-potential river basins. The first requisite is the interconnexion of national systems - beginning with bilateral projects, with a view to the gradual development of a Central American network - in order to consolidate markets, ensure the economicity of new investments and strengthen the organizational, financing and executive capacity of the national agencies.

In the case of Central America, the economic advantages of interconnexion and combined development of large-scale systems are many and various. In the first place, the electric power supply thus made available would be sufficient to cover accumulated deficits and the growth of all types of demand, as well as to encourage the establishment of new agricultural and industrial activities and the expansion and modernization of those already established. Secondly, increased utilization of hydro-electric resources would imply a considerable saving of foreign exchange, and would make the development of the electricity sector less dependent upon the capacity to import.

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All this in turn would tend to bring down the costs of electrification in the area; firstly because the resources developed would be those offering most advantages from the economic standpoint, and secondly because inter-country complementarity possibilities would be turned to account.<sup>15/</sup>

To these economic advantages would be added the profits that might derive from the economies of scale inherent in an increase in the size of the systems, as well as those that would result from the smaller amounts of investment signified by interconnexion and combined development as against purely national programmes. This saving of capital, in conjunction with the income accruing from transfers of power from one country to another, would help to relieve the lack of financial liquidity which is now placing several of the national electrification institutions in a difficult position.

(c) Problems outstanding

The technical and economic aspects of the interconnexion and combined development of electricity systems is one of the fields in which most satisfactory progress has been made under the economic integration movement. Special attention must be drawn to the part played by the Central American Bank in the financing of the relevant studies, as well as to the possibilities of using the Central American Integration Fund to solve financial problems relating to the execution of the works. As in other sectors, however, problems of a different kind still subsist, as hindrances to the execution of regional electrification projects. In analysing such difficulties, a distinction must be drawn between some that are of a short-term character and others relating to what a regional programme might come to represent in the future.

(i) Short-term problems. The first of these concern the inter-connexion projects already studied. The basic studies once completed, the work has not continued to progress, generally speaking, as quickly

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<sup>15/</sup> Cases in point would be afforded by the different types of water resources available in Nicaragua and Costa Rica, and by the integration of thermo and hydro energy resources that would result from the interconnexion between Honduras and El Salvador.

as could be desired. Should this tardiness continue, some of the interconnexion studies may become less valuable or even useless, since they relate to situations existing at a given point of time. If the original conditions alter, owing to the necessity of adopting new investment decisions at the national level, the economic advantages of regional projects will also be modified, and in some cases cease to exist. Failure to take advantage of the existing possibilities would involve a waste of highly important opportunities, and might perhaps handicap programmes for the future expansion and development of the sector.

This relatively slow progress partly reflects the difficulty of introducing adjustments and changes in national programmes, which imply deferring investments already provided for and channelling action in new directions. Another contributory factor has been the insufficient part played by the electrification agencies in the early phases of project preparation, and the lack of proper co-ordination between these agencies and the corresponding planning activities at the national level.

The situation has also been affected by considerations relating to (a) the desirability or undesirability of a country's depending for its supplies on facilities installed outside its territory; (b) the lack of background data on which to base an evaluation of the effects of interconnexion from the standpoint of the inter-country balance of development; and (c) uncertainty as to the results of sharing reserves with neighbouring countries, and apprehension lest the hydro-electric resources already surveyed in some of them may be more quickly exhausted. All this once more underlines the limitations of technical and economic studies as means of elucidating such questions, and the necessity of going more thoroughly into the legal and organizational aspects of projects of this type.

Although the foregoing problems do not in themselves constitute decisive reasons for discarding the projects, they do create various requirements that must be satisfied. These include the formulation of contracts whose legal features are satisfactory to the interested parties,

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and the establishment of guarantees to safeguard the equitable distribution of loads and profits and the satisfaction of aggregate demand in the future.

It would be necessary, therefore, to determine the content of the contracts whereby relations between the participating Governments would be regulated, and to define the operational organization of the inter-connexion system. In this way, procedures would be established for fixing and regulating the electricity tariffs applicable and the profit deriving from inter-country transfers of electric power. Furthermore, in the contracts themselves the necessary guarantees with respect to supplies would be extended, and commitments relating to the future expansion of the systems would be formalized.

In this last respect, the projection and programming of the growth of networks and systems would facilitate the timely preparation of the new projects. It would also enable local and regional aspects of the problem to be more satisfactorily reconciled in the interests of maximum utilization of the technical and economic advantages offered by interconnexion and combined development.

Lastly, in bilateral agreements a distinction should be drawn between the regulations and organizational patterns applicable, on the one hand, to the execution of construction works and the operation of electricity systems, and, on the other, to planning activities proper. In this sense, the progress achieved by the electrification agencies of Honduras and El Salvador and by those of Nicaragua and Costa Rica is encouraging, although insufficient for the successful accomplishment of all the tasks enumerated. In both cases, joint standing committees ought to be established, with clearly-defined terms of reference and adequate technical, administrative and financial resources for the discharge of their functions. These aspects of planning activities are particularly important, and a minimum of full-time personnel should be assigned to them, while at the same time advantage should be taken of the technical assistance and external financing already available.

(ii) Bases for a future programme. The projects available in the field of joint development of electricity systems do not yet constitute a regional electrification programme proper. They must be viewed as initial /experiments in

experiments in the energy sector of the common market, rather than as intrinsically embodying a lasting solution of the problems with which the economic integration movement is faced in this connexion. All that has been attempted hitherto is exploitation, at the Central American level, of the somewhat limited possibilities afforded by the existing national systems.

If the electricity sector is to become a dynamic factor in the integrated development of Central America, more ambitious programmes must be formulated and put into effect, as has already been pointed out. Interconnexion of the national systems might constitute a satisfactory frame of reference for the planning and channelling of joint action on the part of Governments and decentralized national institutions. It also would be essential to obtain detailed information on the amount and location of the water resources available, as well as to organize the study and evaluation of regional potentialities and projects on a continuing basis.

The project for the establishment of a Central American network of hydrometric and hydrometereological stations, scheduled to be embarked upon by the Governments at the end of 1965, with the financial and technical support of the United Nations Special Fund and the World Meteorological Organization, should provide data of considerable significance for programming in the energy sector. A similar contribution will be made by the systematic study of the hydrological information available which is to be carried out in 1966 by the ECLA secretariat, with help from the Central American Electric Power Development Mission, among other sources. However, in view of the acute shortage of basic data, given the magnitude of the tasks in hand, a project like that relating to the hydrometric network should be promoted, with a view to research on the prospects for the harnessing of Central America's water resources. Special emphasis should be placed on the preparation of pre-investment studies relating to the development of various river basins and inland waterways of regional importance.

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The Central American Electrification Sub-Committee might assume the initial responsibility for promoting these activities. But it should be borne in mind that the work will soon reach a stage at which some agency is needed through which greater continuity can be given to the efforts made, on the basis of the intensive participation of national electrification institutions and other bodies dealing with different aspects of the development of water resources (irrigation, flood control and aqueducts).

The agency in question might consist in a commission formed by top-level administrative and executive officials of the bodies concerned, and its principal functions would be to lay down general guiding principles; evaluate the results and decide as to the expansion of programmes; co-ordinate the activities of joint committees and supervise the work of groups of specialized officials; and direct the activities of Central American and foreign experts collaborating in the programmes.

The programme just outlined and the attainment of its objectives, are, by their very nature, long-term undertakings. The predominant characteristic of projects of this type - whether they relate to the evaluation and use of water resources or to the programming and construction of electric power generation and transmission works - is the length of time they take to mature. This fact, in conjunction with the limited number of the projects studied and the rapid growth of demand, leaves no room for doubt as to the urgent need to carry out a regional programme for electric power development and research on hydro-electric resources in Central America.

(iii) Other activities. Apart from these major areas of activity, there are other aspects of the problem that should be carefully studied in connexion with joint electric power development programmes. Particular mention should be made of those relating to the alignment of tariff policies and the standardization of the technical characteristics of electricity systems.

Tariff disparities have begun to arouse concern among the national authorities, on account of the unfavourable influence they may exert on the inter-country balance of development. If these disparities do not

/reflect differences



reflect differences in real costs, but discrepancies in the criteria applied in fixing tariff rates or again, if they are the outcome of less efficient utilization of available resources, they may hamper the regional industrialization process and, in addition, cause undesirable distortions with respect to the location of new activities. It seems advisable, therefore, that basic research should be undertaken without delay, for the purpose of co-ordinating the principles followed in establishing electricity tariffs, and their actual structures.

Furthermore, the standardization of technical characteristics, equipment and material are a desirable and in certain cases even an indispensable condition for the efficient operation of interconnected systems and their subsequent development. But despite the benefits that could result from uniformity in these respects, little progress has been made so far. Apart from the economic advantages previously pointed out, others of some significance could be obtained, such as, for example, those deriving from the joint purchase of equipment and material from abroad, or those that could be turned to account later on for the purposes of establishing the manufacture of such equipment and material in Central America.

#### /IV. INSTITUTIONAL

#### IV. INSTITUTIONAL QUESTIONS

In various sections of the present report specific suggestions are put forward concerning the improvement and development of the institutional organization of the common market.<sup>16/</sup> It would be as well now to examine some of the problems that arise in this field, upon whose solution the future progress of integration would appear to depend in no uncertain measure.

This was not the case in the formative stages of the multinational movement, but once the common market was in operation and had given rise to sound economic prospects, vigorous trade and investment flows and legislative reforms in the member countries, regional institutions responsible for administering the treaties and programmes came to assume a strategic role in Central America's integrated development. Although foreign co-operation and technical assistance will continue to play an important part in research and the provision of supplementary financing, the procedures used will have to be brought into line with the basic requirement of strengthening the regional institutions and establishing at least a minimum of co-ordination between the various programmes.

Broadly speaking, the institutional framework of integration has operated satisfactorily ever since the common market was established. Developments that bear witness to this include the trade and investment trends followed by the market; SIECA's firm position as the permanent secretariat of the integration movement; the increasingly important role played by BCIE - already a well-established and flourishing concern only four years after its entry into operation - in regional financing; the flexible attitude of ICAITI and ESAPAC in orienting their action and adapting it to new needs; the efficiency with which the Executive Council has done its work of administering trade liberalization and tariff equalization; and the successful way in which the Economic Council has solved the few critical situations that have arisen. Therefore, in raising the problems that have emerged in this field it is by no means intended to advocate a radical change in this framework, and still less the replacement of existing institutions by others which might perform the same work along different lines.

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<sup>16/</sup> See, for example, sections II.3(b), II.7(f), II.10(d), III.3(d) (iii), III.4(c) (iv) and III.6(c) (ii).

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However, the magnitude and complex nature of the work to be done and, above all, the unusual increase and diversification of activities bring into focus several questions which it would be wise to deal with promptly. They relate primarily to the need to expand the resources of the regional institutions, to dovetail and co-ordinate their activities on an increasing scale and to establish new agencies to carry out necessary functions or fill obvious gaps.

In the following analysis an attempt is made to differentiate between the problems confronting what might be called the executive bodies - SIECA, BCIE, ICAITI and ESAPAC -, and those affecting the agencies responsible for laying down directives and guidelines for administering the common market and other integration aspects, which might be classified as governing bodies, e.g. the Central American Economic Council and the Executive Council of the General Treaty.

#### 1. Strengthening and co-ordination of the executive bodies

While the initial efforts of SIECA and BCIE have been centred on their consolidation as basic organs of the integration programme, ICAITI and ESAPAC - which were set up in the previous decade - have recently undergone a process of reorganization in terms of the new needs stemming from the establishment of the common market.

Be that as it may, there are at present a number of problems that are common to all those bodies, in connexion with (a) the improvement and training of their technical cadres; (b) the relative weakness of the promotional efforts in sectors or activities of most importance to integration; (c) the lack of adequate co-ordination and reciprocal support in respect of one another's work; and (d) the forging of closer links with government institutions in each country.

The efficient operation of the integration bodies is not dependent solely upon the availability of financial resources and of competent technical and administrative personnel; in addition, the various factors must be gradually adapted and brought into line as part of efficient organizational systems. Nevertheless, highly skilled technicians and administrative personnel must be available if the regional institutions are to be able to offer the assistance and co-operation the countries require. In line with this pattern of ideas it would be advisable, in the near future, to complete the existing cadres with foreign personnel, if it proved difficult or impossible to contract the services of Central American specialists. It thus seems reasonable to adopt the principle that in the immediate future personnel should be recruited on the basis of professional competence and their essential identification with the postulates of integration, instead of only on the basis of nationality.

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At the same time, the formulation of a large-scale programme designed to reinforce and train personnel in the above-mentioned institutions is urgently needed. Hitherto, some officials of integration bodies have been trained through special courses held both inside and outside Central America. Progress could also be made in implementing the project for the expansion of ESAPAC's activities, and in training technical personnel in ICAITI, with the co-operation of experts from abroad. A great deal more could be done by means of a programme devised specifically to meet these institutions' needs, in conjunction with the periodic transfer of personnel between agencies, which would enable better use to be made of the basic technical groups.

In any case, the heavy demand and lack of funds make it imperative to avoid dispersion of effort among these bodies and point to the need for selectivity, work being confined to a few specific fields and problems. This would make it possible not only to improve the allocation of resources but also to base external technical co-operation on a Central American criterion.

Such specialization and selective concentration in the work of the executive integration bodies do not imply drastic changes in their terms of reference. In practice, they were nearly all established to carry out specific and well-defined functions. Thus BCIE is responsible for promoting industrial development and public works on a regional scale; ICAITI, for the adaptation, absorption and development of technology, which are necessary if changes are to be brought about in the area's production structure; ESAPAC, for the development of an efficient administration in each country to deal with the various integration treaties; and SIECA, for ensuring the proper application of treaties and compliance with the resolutions adopted by the governing integration bodies. However, SIECA is in a somewhat different position because its sphere of action has been broadened and diversified.<sup>17/</sup>

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<sup>17/</sup> SIECA's reorganization is analysed in the study which it is preparing at the request of the Central American Economic Council. The OAS/IDB/ECLA/SIECA/BCIE Advisory Committee on Planning has also drawn attention to the need to strengthen and reorganize SIECA's internal structure, by amplifying its regional terms of reference in relation to economic and social programming. See La institucionalización regional de la planificación en Centroamérica, op. cit.

In the case of BCIE and ICAITI, the above ideas are applicable not only to promotional programmes, but also to other services rendered to the private sector. This means that their credit and technical services would be geared to a clear-cut policy as regards fields, order of priority and terms, instead of being merely a passive reflection of demand from the different users. In this way, ICAITI would provide and channel the technical services essential to the development of integration, and BCIE the facilities for financing regional projects and works.

Futhermore, there is obviously a need to establish closer relations between SIECA, BCIE, ICAITI and ESAPAC, and between these institutions and the Central American Economic Council and the Executive Council of the General Treaty. Thus, for example, BCIE's credit services are needed to extend free trade to production activities subjected to transitory restrictions and requiring financial resources in order to specialize or to modernize their plants. ICAITI's services are also indispensable in the above process, since its legal function is to provide technical advice to the two Councils in connexion with the application of uniform fiscal incentives and of the Agreement on the Régime for Central American Integration Industries. Similarly, BCIE's credit policy is conditioned by the rules governing free trade and tariff equalization adopted by the Integration Councils and, in turn, the application of these norms will no doubt be more efficient with assistance from ESAPAC in modernizing and adapting the national administrative structures to common market needs.

For those cases in which such relationships are closest and occur most frequently, it might be advisable to set up special units in each organization. It would likewise be desirable to organize periodical meetings of those institutions for the purpose of examining the respective programmes of work, orienting their activities and evaluating the results of their collaboration in the projects carried out jointly. This would enable them to co-operate more effectively with the governing bodies of the General Treaty.

In certain private and government circles there is concern at the springing up of too many new Central American institutions. But if the

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considerable expansion of the common market's sphere of action is taken into account, it seems clear that the existing bodies are merely the first components of the far larger galaxy of institutions that will be needed if economic integration is to work satisfactorily.

Moreover, in the face of the increase in those needs, a great many proposals have emerged for the establishment of new bodies.<sup>18/</sup> However, the real problem lies in determining which of these bodies must in fact be set up at the different stages of the common market's development, and the characteristics, organization and terms of reference they should be given. In line with these ideas, the safest procedure for effecting innovations in the institutional framework seems to be to determine the points where the development of integration calls for action at the regional level, and to identify the obstacles whose removal would entail the adoption of such measures.

The integration bodies that are already established could play an active part in the setting up of new machinery or institutions designed to bring the regional development programme into full operation, through both the preparation of basic studies and the provision of immediate help and support during the early stages of their incorporation in the institutional framework of the common market. This procedure could be applied in a great many instances; for example, in encouraging BCIE to take the initiative in creating a capital market of regional scope. Likewise, ICAITI could play a similar role in the establishment of specialized industrial research services in the various countries and in the setting up of a regional institution for research on natural resources.

There are several reasons for adopting this course of action. In the first place, since nearly all Central America's skilled personnel has been absorbed by the existing institutions, it will not be an easy

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<sup>18/</sup> The proposals include a regional organization for the maintenance and repair of highways, a fisheries institute, a telecommunications enterprise and an geological research and water resources institution.

matter to establish others unless the necessary technical and administrative resources are made available. It seems to follow, therefore, that the older institutions should supply the new ones with the minimum resources required in the early phases of their organization. Secondly, the prospects of success will be all the greater if the new enterprises are set up under the protection of the strongest integration structures.

Lastly, attention should be drawn to the relations of BCIE, ICAITI and ESAPAC with the national institutions of the member countries. The functions of the first three institutions did not previously exist in Central America. Therefore, it is not essentially a matter of settling problems of duplication and specialization, but rather of the integration mechanisms' contributing new elements that will supplement the action adopted separately by each country. This applies to many fields, but the immediate requirements lie in the banking system, the balance of payments, industrial development and administrative reform.

## 2. Reorganization and improvement of the governing bodies

The flexible and efficient lines along which the Economic Council and the Executive Council have been operating to date have made it possible not only to solve the problems that have arisen, but also to establish the initial bases for a valuable regional system of laws on integration.

However, the changing needs of the common market and, in particular, the growth of its sphere of influence have rendered the existing organization inadequate.

In the first place, the problems claiming the Executive Council's attention are tending to increase rapidly, and are now more than the Council can cope with. The decision to hold periodic meetings has partly relieved the pressure on its agenda. In addition, however, the Governments should relieve their representatives in the Executive Council from all responsibilities or functions other than those related to economic integration. It would also be wise, as far as possible, to ensure the continuity of these officials' tenure of office and to make available to them resources and specialized personnel from other public

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departments when their work so requires. In this way, the Executive Council would be in a position to set up various working groups, which would provide it with technical collaboration in a great many fields, and thus gradually to expand its activities.

Secondly, although the Economic Council and the Executive Council are capable of dealing with a particular type of problem, in certain cases recourse must be had to other bodies. For example, problems connected with transport, electric energy, agricultural development and some aspects of industrial policy call for action at the Central American level from the Ministries of Communications, Public Works, and Agriculture, and from the electrification and development institutes.

Accordingly, as the common market has forged ahead, new inter-governmental machinery and institutions have begun to be established at the Central American level. These include the Monetary Council, the Higher Council of Universities, the Tourist Trade Council, the Labour and Social Security Council, the Meeting of Ministers of Agriculture and the Meeting of Ministers of Finance. What is more, there is apparently a need to set up others to cover several important fields at the same time.

For instance, in the third part of the present report, in analysing the regional programmes by sectors a question raised is the need to institutionalize the meeting of Ministers of Public Works, by establishing the Central American Transport Council and an agency to deal with electrification matters. If this procedure were applied in general, the time would come when there would be a system of sectoral committees similar in structure to the sub-committees of the Central American Economic Co-operation Committee, with working groups to deal with specific questions delegated to them by the committees.

On the other hand, it should be recognized that, although through force of circumstances the sphere of economic integration has gradually expanded, its institutions - except in a very few cases - have not developed on a sufficiently sound and lasting basis or with adequate technical backing, compared, for example, with the organs of the General Treaty and, earlier, the institutions established under the

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auspices of the Central American Economic Co-operation Committee. Two major problems arise here. On the one hand, the desirability of providing those new centres with specialized resources and secretariat services that will meet their requirements from the standpoint of both quantity and quality, and, on the other hand, the imperative need to link them gradually and effectively with other regional bodies, in order to avoid confusion in the development of the institutional framework of integration and to contrive that their structure should be organized and should function as a consistent whole.

Hence the need to strengthen the specific function of directing the various integration activities on a co-ordinated basis, as the number and complexity of the institutional instruments increase. This is of utmost importance if the unity of action that has always existed is to be preserved, since without it the five countries would find it hard to make further headway in integration.

It should be noted that the General Treaty confers this power on the Economic Council and the Executive Council (articles XX and XXI). It is therefore incumbent upon them, in particular upon the Economic Council, to determine how this responsibility is to be fulfilled. In this respect, the main task would no doubt consist in reconciling the function of regional orientation and co-ordination with the actual institutional circumstances in each country, under which the responsibilities connected with economic and social development policy are divided among the Ministries of Economic Affairs and other ministerial departments and autonomous bodies of equal or similar standing.

This is not an easy goal to attain; but considerable progress might be achieved if the Economic Council and the Executive Council were to make an intensive effort to persuade other national institutions to take part in integration and to organize them along the lines of regional mechanism, as well as to encourage the adoption of measures in the various fields. In this respect, joint sessions, such as the meeting of Ministers of Economic Affairs and Public Works (1963), the meeting of Ministers of Economic Affairs and Finance (1965), the meeting of Ministers of Economic Affairs and Agriculture (1965) and the meeting of the Executive Council and the Co-ordinating Committee on Marketing

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and Price Stabilization (1965), properly prepared and duly supplemented by work carried out subsequently by the secretariat and national technical officials for the purpose of implementing their resolutions, might well prove the best means of dealing with questions of common interest to various national bodies and requiring joint decisions.

The comments set forth above relate to existing integration problems and include proposals regarding measures for improving the structure and operation of the present group of integration bodies with respect to some of the needs arising in the current stage reached by the multinational movement. But it should not be concluded from these comments that such proposals would be conducive to lasting solutions. The very goals already achieved are bringing integration to the point where it will be increasingly necessary to encourage the establishment of functions and machinery completely Central American in scope.

Although this refers primarily to situations that will arise in the future, it is also beginning to be reflected in common market needs that are already apparent, as can easily be seen from the analysis contained in other sections of the present report, in respect of various aspects of industrial development, the development of regional transport services and, in particular, the trade policy of the common market as a unit with respect to third countries. Thus, although they may appear adequate as transitory action formulas, some of the proposals set forth in those sections are obviously limited and far from perfect from the standpoint of long-term integration needs.

Once the existence of these situations is accepted, the problem is no longer expressed in terms of the need for further progress towards action increasingly regional in scope, nor of the right moment to achieve it, but rather in terms of how it should be achieved. A study of what has happened in other multinational movements is useful to Central America, not only in regard to their achievements, but also because it indicates that it is precisely at this point that economic integration starts to undergo its severest tests.

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At least two considerations should be borne in mind in this respect. In the first place, it must be clearly seen that entirely Central American functions and mechanisms can be established and consolidated only in so far as they are founded on an intensive participation at a national level and are deeply rooted in the real circumstances prevailing in each country. A fact which should not be lost sight of is that, in conjunction with the regional dimensions it has created, economic integration has come to define far more sharply the national interest and standpoint in relation to its development; hence the medium for Central American action, instead of being alien to the five systems concerned, is merely the procedure they will have to use in solving their own common problems and, in so doing, in gradually forging a broader economic unity.

Secondly, it is also impossible to ignore the close relationship already established between the operation of the existing group of institutions and its gradual evolution towards new, more complex and more comprehensive forms of regional action. Evidently this evolution can take place only on the basis of the efficient performance of the existing bodies in accomplishing the tasks entrusted to them under the terms of the integration treaties in force. The Central American functions and machinery will have to emerge from the experience gained by the five countries in facing new situations which determine those needs. Thus, their formal establishment in terms of reforms and advances in the regional legislation would frequently come to consolidate the positive results of de facto situations developing in this way, instead of preceding them. In this respect, it would seem that some of the fields indicated in the present study - e.g., the co-ordinated development of the manufacturing sector and of the transport and telecommunications services, the inter-connexion and joint development of electric power systems, and trade relations with countries outside the area - offer ample opportunity for the useful large-scale undertaking of accumulating and consolidating valuable experience in this field.